SALISBURY BANCORP INC
Form 10-Q
November 14, 2012

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________ TO ________

Commission file number 0-24751

SALISBURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	06-1514263
(State of other jurisdiction of incorporation)	(IRS Employer Identification No.)

5 Bissell Street, Lakeville, Connecticut	**06039**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (860) 435-9801

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer   Accelerated filer   Non-accelerated filer   Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes . No [X]

The number of shares of Common Stock outstanding as of November 14, 2012 is 1,689,691.

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PART I - FINANCIAL INFORMATION

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Cash and due from banks	$ 6,061	$ 4,829
Interest bearing demand deposits with other banks	59,355	32,057
Total cash and cash equivalents	65,416	36,886
Securities		
Available-for-sale at fair value	125,665	155,794
Held-to-maturity at amortized cost (fair value: $ - and $52)	-	50
Federal Home Loan Bank of Boston stock at cost	5,747	6,032
Loans held-for-sale	1,595	948
Loans receivable, net (allowance for loan losses: $4,179 and $4,076)	377,377	370,766
Other real estate owned	641	2,744
Bank premises and equipment, net	11,619	12,023
Goodwill	9,829	9,829
Intangible assets (net of accumulated amortization: $1,690 and $1,523)	853	1,020
Accrued interest receivable	1,966	2,126
Cash surrender value of life insurance policies	7,239	7,037
Deferred taxes	57	829
Other assets	3,033	3,200
Total Assets	$ 611,037	$ 609,284
LIABILITIES and SHAREHOLDERS' EQUITY		
Deposits		
Demand (non-interest bearing)	$ 90,064	$ 82,202
Demand (interest bearing)	66,535	66,332
Money market	136,512	124,566
Savings and other	100,462	94,503
Certificates of deposit	96,633	103,703
Total deposits	490,206	471,306
Repurchase agreements	2,941	12,148
Federal Home Loan Bank of Boston advances	42,392	54,615
Accrued interest and other liabilities	5,124	4,353
Total Liabilities	540,663	542,422
Commitments and contingencies	-	-
Shareholders' Equity		
Preferred stock - $.01 per share par value		
Authorized: 25,000; Issued: 16,000 (Series B);		
Liquidation preference: $1,000 per share	16,000	16,000
Common stock - $.10 per share par value		
Authorized: 3,000,000;		
Issued: 1,689,691 and 1,688,731	169	169

Paid-in capital	13,158	13,134
Retained earnings	40,175	38,264
Accumulated other comprehensive income (loss), net	872	(705)
Total Shareholders' Equity	70,374	66,862
Total Liabilities and Shareholders' Equity	$ 611,037	$ 609,284

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three months ended		Nine months ended	
Periods ended September 30, (in thousands except per share amounts) unaudited	2012	2011	2012	2011
Interest and dividend income				
Interest and fees on loans	$ 4,500	$ 4,630	$ 13,678	$ 13,989
Interest on debt securities				
Taxable	579	739	1,939	2,255
Tax exempt	495	553	1,539	1,661
Other interest and dividends	33	34	75	109
Total interest and dividend income	5,607	5,956	17,231	18,014
Interest expense				
Deposits	580	748	1,870	2,449
Repurchase agreements	3	19	21	46
Federal Home Loan Bank of Boston advances	452	565	1,398	1,772
Total interest expense	1,035	1,332	3,289	4,267
Net interest and dividend income	4,572	4,624	13,942	13,747
Provision for loan losses	330	180	690	860
Net interest and dividend income after provision for loan losses	4,242	4,444	13,252	12,887
Non-interest income				
Trust and wealth advisory	683	599	2,173	1,861
Service charges and fees	559	534	1,628	1,555
Gains on sales of mortgage loans, net	568	178	1,203	370
Mortgage servicing, net	(9)	(35)	(98)	(8)
Gains on securities, net	-	-	279	11
Other	86	58	252	176
Total non-interest income	1,887	1,334	5,437	3,965
Non-interest expense				
Salaries	1,810	1,816	5,268	5,202
Employee benefits	597	636	2,244	1,919
Premises and equipment	603	582	1,799	1,733
Data processing	369	366	1,190	1,028
Professional fees	299	307	915	887
Collections and OREO	301	152	767	519
FDIC insurance	116	137	363	541
Marketing and community support	92	85	267	245
Amortization of intangibles	56	56	167	167
Other	450	398	1,240	1,149
Total non-interest expense	4,693	4,535	14,220	13,390
Income before income taxes	1,436	1,243	4,469	3,462
Income tax provision	296	204	963	598
Net income	$ 1,140	$ 1,039	$ 3,506	$ 2,864
Net income available to common shareholders	$ 1,094	$ 865	$ 3,328	$ 2,459

Basic and diluted earnings per common share	$ 0.65	$ 0.51	$ 1.97	$ 1.46
Common dividends per share	0.28	0.28	0.84	0.84

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three months ended		Nine months ended	
Periods ended September 30, (in thousands)	2012	2011	2012	2011
Net income	$ 1,140	$ 1,039	$ 3,506	$ 2,864
Other comprehensive income				
Net unrealized gains on securities available-for-sale	921	2,544	2,140	6,144
Reclassification of net realized gains in net income	-	-	279	11
Unrealized gains on securities available-for-sale	921	2,544	2,419	6,155
Income tax expense	(313)	(865)	(822)	(2,093)
Unrealized gains on securities available-for-sale, net of tax	608	1,679	1,597	4,062
Pension plan income (loss)	27	17	(31)	50
Income tax (expense) benefit	(9)	(6)	11	(17)
Pension plan income (loss), net of tax	18	11	(20)	33
Other comprehensive income, net of tax	626	1,690	1,577	4,095
Comprehensive income	$ 1,766	$ 2,729	$ 5,083	$ 6,959

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

(dollars in thousands) unaudited	Common Stock Shares	Common Stock Amount	Preferred Stock	Warrants	Paid-in capital	Retained earnings	Accumulated other com-prehensive income (loss)	Total share-holders' equity
Balances at December 31, 2010	1,687,661	$ 168	$ 8,738	$ 112	$13,200	$ 36,567	$ (3,769)	$ 55,016
Net income for period	-	-	-	-	-	2,864	-	2,864
Other comprehensive income, net of tax	-	-	-	-	-	-	4,095	4,095
Amortization (accretion) of preferred stock	-	-	78	-	-	(78)	-	-
Common stock dividends paid	-	-	-	-	-	(1,418)	-	(1,418)
Issuance of Series B preferred stock	-	-	16,000	-	-	-	-	16,000
Redemption of Series A preferred stock	-	-	(8,816)	-	-	-	-	(8,816)
Preferred stock dividends declared	-	-	-	-	-	(382)	-	(382)
Issuance of common stock for director fees	1,070	1	-	-	27	-	-	28
Balances September 30, 2011	1,688,731	$ 169	$ 16,000	$ 112	$13,227	$ 37,553	$ 326	$ 67,387
Balances at December 31, 2011	1,688,731	$ 169	$ 16,000	$ -	$13,134	$ 38,264	$ (705)	$ 66,862
Net income for period	-	-	-	-	-	3,506	-	3,506
Other comprehensive income, net of tax	-	-	-	-	-	-	1,577	1,577
Common stock dividends paid	-	-	-	-	-	(1,419)	-	(1,419)
Preferred stock dividends declared	-	-	-	-	-	(176)	-	(176)
Issuance of common stock for director fees	960	-	-	-	24	-	-	24
Balances at September 30, 2012	1,689,691	$ 169	$ 16,000	$ -	$13,158	$ 40,175	$ 872	$ 70,374

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Nine months ended September 30, (in thousands) unaudited	2012	2011
Operating Activities		
Net income	$ 3,506	$ 2,864
Adjustments to reconcile net income to net cash provided by operating activities:		
(Accretion), amortization and depreciation		
Securities	464	222
Bank premises and equipment	666	631
Core deposit intangible	167	167
Mortgage servicing rights	278	165
Fair value adjustment on loans	25	33
Gains on calls of securities available-for-sale	(12)	(11)
Gains on sales of securities available-for-sale	(267)	-
Loss on sale/disposals of premises and equipment	24	-
Loss recognized on other real estate owned	24	-
Write down of other real estate owned	-	231
Provision for loan losses	690	860
(Increase) decrease in loans held-for-sale	(647)	127
Increase in deferred loan origination fees and costs, net	(44)	(122)
Mortgage servicing rights originated	(504)	(181)
Decrease in mortgage servicing rights impairment reserve	89	80
Decrease in interest receivable	160	90
Deferred tax benefit	(39)	(41)
(Increase) decrease in prepaid expenses	(87)	371
Increase in cash surrender value of life insurance policies	(202)	(120)
Decrease in income tax receivable	420	728
(Increase) decrease in other assets	(29)	10
Increase (decrease) in accrued expenses	766	(235)
Decrease in interest payable	(53)	(152)
Increase (decrease) in other liabilities	47	(607)
Issuance of shares for directors' fee	24	28
Net cash provided by operating activities	5,466	5,138
Investing Activities		
Proceeds from maturities of interest-bearing time deposits	-	5,000
Purchases of securities available-for-sale	-	(35,729)
Redemption of Federal Home Loan Bank stock	285	-
Proceeds from calls of securities available-for-sale	12,668	27,560
Proceeds from maturities of securities available-for-sale	16,928	10,457
Proceeds from sale of securities available-for-sale	2,767	-
Proceeds from maturities of securities held-to-maturity	50	4
Loan originations and principle collections, net	(6,986)	(11,569)
Recoveries of loans previously charged-off	37	55
Proceeds from sale of other real estate owned	1,745	655
Capital expenditures	(286)	(504)
Net cash provided (used) by investing activities	27,208	(4,071)
Financing Activities		

Increase in deposit transaction accounts, net	25,970	68,081
Decrease in time deposits, net	(7,070)	(19,779)
(Decrease) increase in securities sold under agreements to repurchase, net	(9,207)	1,596
Principal payments on Federal Home Loan Bank of Boston advances	(12,223)	(17,779)
Redemption of Series A preferred stock	-	(8,816)
Proceeds from issuance of Series B preferred stock	-	16,000
Common stock dividends paid	(1,419)	(1,418)
Preferred stock dividends paid	(195)	(343)
Net cash (used) provided by financing activities	(4,144)	37,542
Net increase in cash and cash equivalents	28,530	38,609
Cash and cash equivalents, beginning of period	36,886	26,908
Cash and cash equivalents, end of period	$ 65,416	$ 65,517
Cash paid during period		
Interest	$ 3,342	$ 4,419
Income taxes	582	(89)
Non-cash transfers		
Transfer from loans to other real estate owned	666	314
Loans originated to finance the sale of other real estate owned	(1,000)	-

Salisbury Bancorp, Inc. and Subsidiary

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The interim (unaudited) consolidated financial statements of Salisbury Bancorp, Inc. ("Salisbury") include those of Salisbury and its wholly owned subsidiary, Salisbury Bank and Trust Company (the "Bank"). In the opinion of management, the interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position of Salisbury and the statements of income, comprehensive income, shareholders' equity and cash flows for the interim periods presented.

The financial statements have been prepared in accordance with generally accepted accounting principles. In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and valuation of real estate, management obtains independent appraisals for significant properties.

Certain financial information, which is normally included in financial statements prepared in accordance with generally accepted accounting principles, but which is not required for interim reporting purposes, has been condensed or omitted. Operating results for the interim period ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in Salisbury's 2011 Annual Report on Form 10-K for the period ended December 31, 2011.

The allowance for loan losses is a significant accounting policy and is presented in the Notes to Consolidated Financial Statements and in Management's Discussion and Analysis, which provide information on how significant assets are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective judgments, and as such could be most subject to revision as new information becomes available.

Impact of New Accounting Pronouncements Issued

In December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. The amendments in this update defer those changes in ASU 2011-05 that relate to the presentation of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. All other requirements in ASU 2011-05 are not affected by this update. The amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-12 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-11, “Disclosures about Offsetting Assets and Liabilities.” This ASU is to enhance current disclosures. Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The amendments in this ASU are effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of ASU 2011-11 is not expected to have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, “Intangibles – Goodwill and Other”, an update to ASC 350, “Intangibles – Goodwill and Other.” ASU 2011-08 simplifies how entities, both public and nonpublic, test goodwill for impairment. The amendments in this update permit an entity to first assess qualitative factors to determine whether it is more likely than not the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. For public and nonpublic entities, the amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of ASU 2011-08 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, “Presentation of Comprehensive Income.” The objective of this ASU is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Under this ASU, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. An entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. An entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments in this ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards.” The amendments in this ASU explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In April 2011, the FASB issued ASU 2011-03, “Reconsideration of Effective Control for Repurchase Agreements.” The objective of this ASU is to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This ASU prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. The guidance in this ASU is effective for the first interim or annual period beginning on or after December 15, 2011. Early adoption is not permitted. The adoption of ASU 2011-03 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In April 2011, the FASB issued ASU 2011-02, “A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.” This ASU provides additional guidance or clarification to help creditors determine whether a restructuring constitutes a troubled debt restructuring. For public entities, the amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011, and were applied retrospectively to the beginning of the 2011 annual period. The adoption of ASU 2011-02 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

NOTE 2 - SECURITIES

The composition of securities is as follows:

(in thousands)	Amortized cost (1)	Gross un-realized gains	Gross un-realized losses	Fair value
September 30, 2012				
Available-for-sale				
U.S. Treasury notes	$ 2,495	$ 250	$ -	$ 2,745
U.S. Government Agency notes	7,517	238	-	7,755
Municipal bonds	45,363	2,107	(286)	47,184
Mortgage backed securities				
U.S. Government Agencies	45,214	1,547	(1)	46,760
Collateralized mortgage obligations				
U.S. Government Agencies	5,671	79	-	5,750
Non-agency	11,969	534	(119)	12,384
SBA bonds	2,946	87	-	3,033
Preferred Stock	20	34	-	54
Total securities available-for-sale	$ 121,195	$ 4,876	$ (406)	$ 125,665
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 5,747	$ -	$ -	$ 5,747

(in thousands)	Amortized cost (1)	Gross un-realized gains	Gross un-realized losses	Fair value
December 31, 2011				
Available-for-sale				
U.S. Treasury notes	$ 5,000	$ 528	$ -	$ 5,528
U.S. Government Agency notes	14,544	380	-	14,924
Municipal bonds	50,881	1,067	(1,152)	50,796
Mortgage backed securities				
U.S. Government Agencies	57,193	1,126	(19)	58,300
Collateralized mortgage obligations				
U.S. Government Agencies	7,077	76	-	7,153
Non-agency	14,300	355	(488)	14,167
SBA bonds	3,629	77	-	3,706
Corporate bonds	1,100	4	-	1,104
Preferred Stock	20	96	-	116
Total securities available-for-sale	$ 153,744	$ 3,709	$ (1,659)	$ 155,794
Held-to-maturity				
Mortgage backed security	$ 50	$ 2	$ -	$ 52
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 6,032	$ -	$ -	$ 6,032

(1) Net of other-than-temporary impairment write-down recognized in earnings.

Salisbury sold a $2,500,000 Treasury bond available-for-sale during the nine month period ended September 30, 2012. The gain recognized on this sale was $267,000. Salisbury did not sell any securities available-for-sale in the nine months ended September 30, 2011.

The following table summarizes, for all securities in an unrealized loss position, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income, the aggregate fair value and gross unrealized loss of securities that have been in a continuous unrealized loss position as of the date presented:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized losses	Fair value	Unrealized losses	Fair Value	Unrealized losses

(in thousands)						
September 30, 2012						
Available-for-sale						
Municipal bonds	$ 592	$ 5	$2,892	$ 280	$3,484	$ 285
Mortgage backed securities	-	-	53	1	53	1
Collateralized mortgage obligations						
Non-agency	-	-	1,612	27	1,612	27
Total temporarily impaired securities	592	5	4,557	308	5,149	313
Other-than-temporarily impaired securities						
Collateralized mortgage obligations						
Non-agency	-	-	2,053	93	2,053	93
Total temporarily and other-than-temporarily impaired securities	$ 592	$ 5	$6,610	$ 401	$7,202	$ 406

Salisbury evaluates securities for Other Than Temporary Impairment ("OTTI") where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

The following summarizes, by security type, the basis for evaluating if the applicable securities were OTTI at September 30, 2012.

U.S Government Agency notes, U.S. Government Agency mortgage-backed securities and U.S. Government Agency CMOs: The contractual cash flows are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these securities to be OTTI at September 30, 2012.

Municipal bonds: Contractual cash flows are performing as expected. Salisbury purchased substantially all of these securities during 2006-to-2008 as bank qualified, insured, AAA rated general obligation or revenue bonds. Salisbury's portfolio is mostly comprised of tax-exempt general obligation bonds or public-purpose revenue bonds for schools, municipal offices, sewer infrastructure and fire houses, for small towns and municipalities across the United States. In the wake of the financial crisis, most monoline bond insurers had their ratings downgraded or withdrawn because of excessive exposure to insurance for collateralized debt obligations. Where appropriate, Salisbury performs credit underwriting reviews of issuers, including some that have had their ratings withdrawn or are insured by insurers that have had their ratings withdrawn, to assess default risk. Management expects to recover the entire amortized cost basis of these securities. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity. Management does not consider these securities to be OTTI at September 30, 2012.

Non-agency CMOs: Salisbury performed a detailed cash flow analysis of its non-agency CMOs at September 30, 2012 to assess whether any of the securities were OTTI. Salisbury uses third party provided cash flow forecasts of each security based on a variety of market driven assumptions and securitization terms, including prepayment speed, default or delinquency rate, and default severity for losses including interest, legal fees, property repairs, expenses and realtor fees, that, together with the loan amount are subtracted from collateral sales proceeds to determine severity. In

2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of $1,128,000. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of September 30, 2012. It is possible that future loss assumptions could change, necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis.

The following table presents activity related to credit losses recognized into earnings on the non-agency CMOs held by Salisbury for which a portion of an OTTI charge was recognized in accumulated other comprehensive income:

Nine months ended September 30 (in thousands)		2012		2011
Balance, beginning of period	$	1,128	$	1,128
Credit component on debt securities in which OTTI was not previously recognized	-		-	
Balance, end of period	$	1,128	$	1,128

Federal Home Loan Bank of Boston (“FHLBB”): The Bank is a member of the FHLBB. The FHLBB is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. In 2008, the FHLBB announced to its members that it is focusing on preserving capital in response to ongoing market volatility including the extension of a moratorium on excess stock repurchases, and in 2009 announced the suspension of its quarterly dividends. In 2011, the FHLBB resumed modest quarterly cash dividends to its members and in early 2012 the FHLBB repurchased its excess stock pool. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank’s FHLBB stock as of September 30, 2012. Further deterioration of the FHLBB’s capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

NOTE 3 - LOANS

The composition of loans receivable and loans held-for-sale is as follows:

(in thousands)	September 30, 2012	December 31, 2011
Residential 1-4 family	$ 196,976	$ 187,676
Residential 5+ multifamily	3,604	3,187
Construction of residential 1-4 family	4,044	5,305
Home equity credit	35,263	34,621
Residential real estate	239,887	230,789
Commercial	83,219	81,958
Construction of commercial	5,416	7,069
Commercial real estate	88,635	89,027
Farm land	4,364	4,925
Vacant land	11,172	12,828
Real estate secured	344,058	337,569
Commercial and industrial	28,893	29,358
Municipal	3,083	2,415
Consumer	4,474	4,496
Loans receivable, gross	380,508	373,838
Deferred loan origination fees and costs, net	1,048	1,004
Allowance for loan losses	(4,179)	(4,076)
Loans receivable, net	$ 377,377	$ 370,766
Loans held-for-sale		
Residential 1-4 family	$ 1,595	$ 948

Concentrations of Credit Risk

Salisbury's loans consist primarily of residential and commercial real estate loans located principally in northwestern Connecticut and nearby New York and Massachusetts towns, which constitute Salisbury's service area. Salisbury offers a broad range of loan and credit facilities to borrowers in its service area, including residential mortgage loans, commercial real estate loans, construction loans, working capital loans, equipment loans, and a variety of consumer loans, including home equity lines of credit, and installment and collateral loans. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability of single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the market area and real estate values. The ability of commercial borrowers to honor their repayment commitments is dependent on the general economy as well as the health of the real estate economic sector in Salisbury’s market area.

Credit Quality

The composition of loans receivable by credit risk rating is as follows:

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2012						
Residential 1-4 family	$ 179,426	$ 13,568	$ 3,982	$ -	$ -	$ 196,976
Residential 5+ multifamily	2,823	781	-	-	-	3,604
Construction of residential 1-4 family	3,249	-	795	-	-	4,044
Home equity credit	31,986	1,920	1,357	-	-	35,263
Residential real estate	217,484	16,269	6,134	-	-	239,887

Commercial	61,680	10,704	10,294	541	-	83,219
Construction of commercial	4,646	299	471	-	-	5,416
Commercial real estate	66,326	11,003	10,765	541	-	88,635
Farm land	2,828	344	1,192	-	-	4,364
Vacant land	5,725	868	4,579	-	-	11,172
Real estate secured	292,363	28,484	22,670	541	-	344,058
Commercial and industrial	20,237	6,464	2,192	-	-	28,893
Municipal	3,083	-	-	-	-	3,083
Consumer	4,270	171	33	-	-	4,474
Loans receivable, gross	$ 319,953	$ 35,119	$ 24,895	$ 541	$ -	$ 380,508

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
December 31, 2011						
Residential 1-4 family	$ 168,326	$ 15,517	$ 3,833	$ -	$ -	$ 187,676
Residential 5+ multifamily	2,752	435	-	-	-	3,187
Construction of residential 1-4 family	4,116	415	774	-	-	5,305
Home equity credit	31,843	1,451	1,327	-	-	34,621
Residential real estate	207,037	17,818	5,934	-	-	230,789
Commercial	64,458	6,187	11,313	-	-	81,958
Construction of commercial	6,296	302	471	-	-	7,069
Commercial real estate	70,754	6,489	11,784	-	-	89,027
Farm land	2,327	1,768	830	-	-	4,925
Vacant land	8,039	883	3,906	-	-	12,828
Real estate secured	288,157	26,958	22,454	-	-	337,569
Commercial and industrial	21,104	6,847	1,407	-	-	29,358
Municipal	2,415	-	-	-	-	2,415
Consumer	4,254	178	64	-	-	4,496
Loans receivable, gross	$ 315,930	$ 33,983	$ 23,925	$ -	$ -	$ 373,838

Credit quality segments of loans receivable by credit risk rating are as follows:

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2012						
Performing loans	$ 318,822	$ 33,540	$ -	$ -	$ -	$ 352,362
Potential problem loans	-	-	12,110	-	-	12,110
Troubled debt restructurings: accruing	1,131	1,579	4,097	-	-	6,807
Troubled debt restructurings: non-accrual	-	-	1,962	-	-	1,962
Other non-accrual loans	-	-	6,726	541	-	7,267
Impaired loans	1,131	1,579	12,785	541	-	16,036
Loans receivable, gross	$ 319,953	$ 35,119	$ 24,895	$ 541	$ -	$ 380,508
December 31, 2011						
Performing loans	$ 314,551	$ 32,570	$ -	$ -	$ -	$ 347,121
Potential problem loans	-	-	14,039	-	-	14,039
Troubled debt restructurings: accruing	1,379	1,413	1,810	-	-	4,602
Troubled debt restructurings: non-accrual	-	-	1,753	-	-	1,753
Other non-accrual loans	-	-	6,323	-	-	6,323
Impaired loans	1,379	1,413	9,886	-	-	12,678
Loans receivable, gross	$ 315,930	$ 33,983	$ 23,925	$ -	$ -	$ 373,838

Potential problem loans are performing loans risk rated substandard that are not classified as impaired. Impaired loans are loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.

The composition of loans receivable delinquency status by credit risk rating is as follows:

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2012						
Current	$ 315,252	$ 30,883	$ 14,043	$ -	$ -	$ 360,178
Past due 001-029	4,116	2,954	1,447	-	-	8,517
Past due 030-059	543	362	1,458	-	-	2,363
Past due 060-089	42	920	1,551	-	-	2,513
Past due 090-179	-	-	634	-	-	634
Past due 180+	-	-	5,762	541	-	6,303
Loans receivable, gross	$ 319,953	$ 35,119	$ 24,895	$ 541	$ -	$ 380,508
December 31, 2011						
Current	$ 311,741	$ 31,407	$ 12,618	$ -	$ -	$ 355,766
Past due 001-029	3,696	1,195	3,517	-	-	8,408
Past due 030-059	435	1,024	674	-	-	2,133
Past due 060-089	58	357	46	-	-	461
Past due 090-179	-	-	1,095	-	-	1,095
Past due 180+	-	-	5,975	-	-	5,975
Loans receivable, gross	$ 315,930	$ 33,983	$ 23,925	$ -	$ -	$ 373,838

The composition of loans receivable by delinquency status is as follows:

(in thousands)	Current	Past due 1-29 days	30-59 days	60-89 days	90-179 days	180 days and over	30 days and over	Accruing 90 days and over	Non-accrual
September 30, 2012									
Residential 1-4 family	$ 190,863	$ 4,174	$ 745	$ 488	$ 498	$ 208	$ 1,939	$ -	$ 1,157
Residential 5+ multifamily	3,363	134	-	107	-	-	107	-	-
Residential 1-4 family construction	4,044	-	-	-	-	-	-	-	-
Home equity credit	34,059	420	58	428	92	206	784	-	299
Residential real estate	232,329	4,728	803	1,023	590	414	2,830	-	1,456
Commercial	77,516	2,365	1,146	313	-	1,879	3,338	-	2,739
Construction of commercial	5,272	-	144	-	-	-	144	-	21
Commercial real estate	82,788	2,365	1,290	313	-	1,879	3,482	-	2,760
Farm land	3,974	14	-	376	-	-	376	-	-
Vacant land	5,619	933	229	789	44	3,558	4,620	-	4,391
Real estate secured	324,710	8,040	2,322	2,501	634	5,851	11,308	-	8,607
Commercial and industrial	28,024	417	-	-	-	452	452	-	622
Municipal	3,083	-	-	-	-	-	-	-	-
Consumer	4,361	60	41	12	-	-	53	-	-
	$360,178	$ 8,517	$ 2,363	$ 2,513	$ 634	$ 6,303	$11,813	$ -	$ 9,229

Loans receivable, gross									
December 31, 2011									
Residential 1-4 family	$ 182,263	$ 3,772	$ 811	$ 121	$ -	$ 709	$ 1,641	$ -	$ 1,240
Residential 5+ multifamily	2,918	-	112	157	-	-	269	-	-
Residential 1-4 family construction	5,305	-	-	-	-	-	-	-	-
Home equity credit	34,124	298	50	-	83	66	199		173
Residential real estate	224,610	4,070	973	278	83	775	2,109	-	1,413
Commercial	75,486	3,887	483	180	930	992	2,585	-	2,317
Construction of commercial	6,796	108	145	-	20	-	165	-	20
Commercial real estate	82,282	3,995	628	180	950	992	2,750	-	2,337
Farm land	4,499	46	380	-	-	-	380	-	-
Vacant land	9,047	73	50	-	-	3,658	3,708	-	3,658
Real estate secured	320,438	8,184	2,031	458	1,033	5,425	8,947	-	7,408
Commercial and industrial	28,542	152	51	1	62	550	664	-	668
Municipal	2,415	-	-	-	-	-	-	-	-
Consumer	4,371	72	51	2	-	-	53	-	-
Loans receivable, gross	$355,766	$ 8,408	$ 2,133	$ 461	$1,095	$ 5,975	$ 9,664	$ -	$ 8,076

Troubled Debt Restructurings

Troubled debt restructurings occurring during the periods are as follows:

(in thousands)	Three months ended September 30, 2012			Nine months ended September 30, 2012		
	Quantity	Pre-modification balance	Post-modification balance	Quantity	Pre-modification balance	Post-modification balance
Commercial real estate	6	$ 554	$ 554	7	$ 2,124	$ 2,124
Commercial and industrial	-	-	-	5	779	779
Residential real estate	-	-	-	1	326	326
Troubled debt restructurings	6	$ 554	$ 554	13	$ 3,229	$ 3,229
Debt consolidation and term extension	-	$ -	$ -	4	$ 2,276	$ 2,276
Rate reduction and term extension	1	140	140	3	513	513
Rate reduction	2	280	280	2	280	280
Refinance	1	80	80	1	80	80
Modification pursuant to bankruptcy	1	33	33	1	33	33
	-	-	-	1	26	26

Seasonal interest only concession						
Term extension and amortization	1	21	21	1	21	21
Troubled debt restructurings	6	$ 554	$ 554	13	$ 3,229	$ 3,229

Thirteen loans were restructured during the first nine months of 2012. At September 30, 2012 two loans totaling $280,000 were past due 30-59 days and eleven loans were current.

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

	Three months ended September 30					Nine months ended September 30				
(in thousands)	Beginning balance	Provision (benefit)	Charge-offs	Recoveries	Ending balance	Beginning balance	Provision (benefit)	Charge-offs	Recoveries	Ending balance
2012 Periods										
Residential	$ 1,475	$ 92	$ (88)	$ -	$ 1,479	$ 1,478	$ 226	$ (225)	$ -	$1,479
Commercial	1,277	(206)	(41)	3	1,033	1,139	(72)	(41)	7	1,033
Land	219	318	(224)	-	313	410	169	(266)	-	313
Real estate	2,971	204	(353)	3	2,825	3,027	323	(532)	7	2,825
Commercial & industrial	820	(23)	-	1	798	704	114	(29)	9	798
Municipal	27	6	-	-	33	24	9	-	-	33
Consumer	66	74	(14)	5	131	79	92	(63)	22	130
Unallocated	323	69	-	-	392	242	152	-	(1)	393
Totals	$ 4,207	$ 330	$ (367)	$ 9	$ 4,179	$ 4,076	$ 690	$ (624)	$ 37	$ 4,179
2011 Periods										
Residential	$ 1,583	$ 73	$ (50)	$ -	$ 1,606	$ 1,504	$ 269	$ (170)	$ 3	$ 1,606
Commercial	1,239	(145)	(30)	1	1,065	1,132	138	(206)	1	1,065
Land	271	179	(75)	-	375	392	137	(154)	-	375
Real estate	3,093	107	(155)	1	3,046	3,028	544	(530)	4	3,046
Commercial & industrial	521	(92)	-	29	458	541	(22)	(89)	29	459
Municipal	28	(3)	-	-	25	51	(26)	-	-	25
Consumer	90	8	(10)	3	91	164	94	(189)	22	91
Unallocated	247	160	-	-	407	136	270	-	0	406
Totals	$ 3,979	$ 180	$ (165)	$ 33	$ 4,027	$ 3,920	$ 860	$ (808)	$ 55	$ 4,027

The composition of loans receivable and the allowance for loan losses is as follows:

(in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
September 30, 2012						
Residential 1-4 family	$ 192,610	$ 774	$ 4,366	$ 252	$ 196,976	$ 1,026
Residential 5+ multifamily	2,867	22	737	-	3,604	22
Construction of residential 1-4 family	4,044	19	-	-	4,044	19
Home equity credit	34,941	391	322	22	35,263	413
Residential real estate	234,462	1,206	5,425	274	239,887	1,480
Commercial	76,686	879	6,533	93	83,219	972
Construction of commercial	5,395	60	21	-	5,416	60
Commercial real estate	82,081	939	6,554	93	88,635	1,032
Farm land	4,364	67	-	-	4,364	67
Vacant land	6,641	78	4,531	167	11,172	245
Real estate secured	327,548	2,290	16,510	534	344,058	2,824
Commercial and industrial	26,887	352	2,006	447	28,893	799
Municipal	3,083	34	-	-	3,083	34
Consumer	4,083	40	391	90	4,474	130
Unallocated allowance	-	392	-	-	-	392
Totals	$ 361,601	$ 3,108	$ 18,907	$ 1,071	$ 380,508	$ 4,179

(in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
December 31, 2011						
Residential 1-4 family	$ 182,695	$ 762	$ 4,981	$ 297	$ 187,676	$ 1,059
Residential 5+ multifamily	2,437	17	750	4	3,187	21
Construction of residential 1-4 family	4,606	17	699	-	5,305	17
Home equity credit	34,333	382	288	-	34,621	382
Residential real estate	224,071	1,178	6,718	301	230,789	1,479
Commercial	74,419	840	7,539	202	81,958	1,042
Construction of commercial	7,049	77	20	20	7,069	97
Commercial real estate	81,468	917	7,559	222	89,027	1,139
Farm land	4,095	35	830	150	4,925	185
Vacant land	9,021	104	3,807	120	12,828	224
Real estate secured	318,655	2,234	18,914	793	337,569	3,027
Commercial and industrial	28,091	368	1,267	336	29,358	704
Municipal	2,415	24	-	-	2,415	24
Consumer	4,431	44	65	35	4,496	79
Unallocated allowance	-	-	-	-	-	242
Totals	$ 353,592	$ 2,670	$ 20,246	$ 1,164	$ 373,838	$ 4,076

The credit quality segments of loans receivable and the allowance for loan losses are as follows:

(in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
September 30, 2012						
Performing loans	$ 351,971	$ 2,426	$ 391	$ 90	$ 352,362	$ 2,516
Potential problem loans	9,630	289	2,480	61	12,110	350
Impaired loans	-	-	16,036	920	16,036	920
Unallocated allowance	-	-	-	-	-	393
Totals	$ 361,601	$ 2,715	$ 18,907	$ 1,071	$ 380,508	$ 4,179
December 31, 2011						
Performing loans	$ 346,303	$ 2,436	$ 819	$ 35	$ 347,122	$ 2,471
Potential problem loans	7,289	234	6,750	255	14,039	489
Impaired loans	-	-	12,677	874	12,677	874
Unallocated allowance	-	-	-	-	-	242
Totals	$ 353,592	$ 2,670	$ 20,246	$ 1,164	$ 373,838	$ 4,076

Certain data with respect to impaired loans individually evaluated is as follows:

	Impaired loans with specific allowance					Impaired loans with no specific allowance			
(in thousands)	Loan balance			Specific	Income	Loan balance			Income
	Book	Note	Average	allowance	recognized	Book	Note	Average	recognized
September 30, 2012									
Residential 1-4 family	$ 1,983	$ 2,065	$ 2,966	$ 198	$ 36	$ 1,593	$ 1,654	$ 2,054	$ 26
Home equity credit	206	206	142	22	-	93	111	333	-
Residential real estate	2,189	2,271	3,108	220	36	1,686	1,765	2,387	26
Commercial	2,345	2,532	2,742	93	55	3,445	3,875	4,318	56
Vacant land	3,320	3,541	1,299	160	-	1,071	1,867	4,012	4
Real estate secured	7,854	8,344	7,149	473	91	6,202	7,507	10,717	86
Commercial and industrial	1,044	1,132	1,272	447	13	936	1,690	1,262	28
Consumer	-	-	-	-	-	-	142	-	-
Totals	$8,898	$9,476	$ 8,421	$ 920	$ 104	$7,138	$9,339	$ 11,979	$ 114

	Impaired loans with specific allowance					Impaired loans with no specific allowance			
(in thousands)	Loan balance			Specific	Income	Loan balance			Income
	Book	Note	Average	allowance	recognized	Book	Note	Average	recognized
December 31, 2011									
Residential 1-4 family	$ 3,012	$ 3,160	$ 1,822	$ 266	$ 38	$ 390	$ 426	$ 3,875	$ -
Home equity credit	-	-	-	-	-	173	177	227	-
Residential real estate	3,012	3,160	1,822	266	38	563	603	4,102	-

Commercial	2,151	2,405	2,550	203	77	2,157	2,612	2,175	37
Vacant land	594	774	639	70	-	3,063	3,627	3,243	-
Real estate secured	5,757	6,339	5,011	539	115	5,783	6,842	9,520	37
Commercial and industrial	560	639	364	335	-	577	1,221	876	16
Consumer	-	-	-	-	-	-	142	14	-
Totals	$6,317	$6,978	$ 5,375	$ 874	$ 115	$6,360	$8,205	$ 10,410	$ 53

NOTE 4 - MORTGAGE SERVICING RIGHTS

Loans serviced for others are not included in the Consolidated Balance Sheets. The balance of loans serviced for others and the fair value of mortgage servicing rights are as follows:

September 30, (in thousands)	2012	2011
Residential mortgage loans serviced for others	$ 141,834	$ 105,256
Fair value of mortgage servicing rights	989	695

Changes in mortgage servicing rights are as follows:

	Three months		Nine months	
Periods ended September 30, (in thousands)	2012	2011	2012	2011
Loan Servicing Rights				
Balance, beginning of period	$ 916	$ 674	$ 772	$ 683
Originated	197	75	504	181
Amortization (1)	(115)	(50)	(278)	(165)
Balance, end of period	998	699	998	699
Valuation Allowance				
Balance, beginning of period	(123)	(25)	(22)	(10)
(Increase) decrease in impairment reserve (1)	12	(65)	(89)	(80)
Balance, end of period	(111)	(90)	(111)	(90)
Loan servicing rights, net	$ 887	$ 609	$ 887	$ 609

(1) Amortization expense and changes in the impairment reserve are recorded in loan servicing fee income.

NOTE 5 - PLEDGED ASSETS

The following securities and loans were pledged to secure public and trust deposits, securities sold under agreements to repurchase, FHLBB advances and credit facilities available.

(in thousands)	September 30, 2012	December 31, 2011
Securities available-for-sale (at fair value)	$ 57,111	$ 68,839
Loans receivable	100,086	132,720
Total pledged assets	$ 157,197	$ 201,559

At September 30, 2012, securities were pledged as follows: $46.3 million to secure public deposits, $10.6 million to secure repurchase agreements and $0.2 million to secure FHLBB advances. Loans receivable were pledged to secure FHLBB advances and credit facilities.

NOTE 6 – EARNINGS PER SHARE

	Three months		Nine months	
Periods ended September 30, (in thousands, except per share amounts)	2012	2011	2012	2011
Net income	$ 1,140	$ 1,039	$ 3,506	$ 2,864
Preferred stock net accretion	-	(67)	-	(78)
Preferred stock dividends paid	(46)	(107)	(178)	(327)
Net income available to common shareholders	$ I,094	$ 865	$ K,328	$ 2,459
Weighted average common stock outstanding – basic	1,690	1,689	1,690	1,688
Weighted average common and common equivalent stock outstanding- diluted	1,690	1,689	1,690	1,688
Earnings per common and common equivalent share				

Basic	$ 0.65	$ 0.51	$ 1.97	$ 1.46
Diluted	0.65	0.51	1.97	1.46

NOTE 7 – SHAREHOLDERS' EQUITY

Capital Requirements

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional and discretionary actions by the regulators that, if undertaken, could have a direct material effect on Salisbury and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Salisbury and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Salisbury and the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined) to average assets (as defined) and total and Tier 1 capital (as defined) to risk-weighted assets (as defined). Management believes, as of September 30, 2012, that Salisbury and the Bank meet all of their capital adequacy requirements.

The Bank was classified, as of its most recent notification, as "well capitalized". The Bank's actual regulatory capital position and minimum capital requirements as defined "To Be Well Capitalized Under Prompt Corrective Action Provisions" and "For Capital Adequacy Purposes" are as follows:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2012						
Total Capital (to risk-weighted assets)						
Salisbury	$ 63,045	17.00%	$ 29,667	8.0%	n/a	-
Bank	52,779	14.05	30,058	8.0	$ 37,573	10.0%
Tier 1 Capital (to risk-weighted assets)						
Salisbury	58,819	15.86	14,834	4.0	n/a	-
Bank	48,554	12.92	15,029	4.0	22,534	6.0
Tier 1 Capital (to average assets)						
Salisbury	58,819	9.78	24,066	4.0	n/a	-
Bank	48,554	8.07	24,065	4.0	30,081	5.0
December 31, 2011						
Total Capital (to risk-weighted assets)						
Salisbury	$ 60,869	15.97%	$ 30,490	8.0%	n/a	-
Bank	50,729	13.16	30,840	8.0	$ 38,550	10.0%
Tier 1 Capital (to risk-weighted assets)						
Salisbury	56,718	14.88	15,245	4.0	n/a	-
Bank	46,578	12.08	15,420	4.0	23,130	6.0
Tier 1 Capital (to average assets)						
Salisbury	56,718	9.45	24,014	4.0	n/a	-
Bank	46,578	7.77	23,969	4.0	29,961	5.0

DIVIDENDS

Cash Dividends to Common Shareholders

Salisbury's ability to pay cash dividends is substantially dependent on the Bank's ability to pay cash dividends to Salisbury. Under Connecticut law, a bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by a bank shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

Federal Reserve Board ("FRB") Supervisory Letter SR 09-4, February 24, 2009, revised March 27, 2009, notes that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the FRB and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the FRB reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital structure.

Preferred Stock Dividends

In August 2011, Salisbury issued to the U.S. Secretary of the Treasury (the "Treasury") $16,000,000 of its Series B Preferred Stock under the Small Business Lending Fund (the "SBLF") program. The SBLF program is a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion. The Preferred Stock qualifies as Tier 1 capital for regulatory purposes and ranks senior to the Common Stock.

The Series B Preferred Stock pays noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial quarterly dividend period ending September 30, 2011 and each of the next nine quarterly dividend periods the Series B Preferred Stock is outstanding is determined each quarter based on the increase in the Bank's Qualified Small Business Lending. The dividend rates for the quarterly dividend periods ended September 30, 2012 and June 30, 2012, were 1.15625% and 1.51925%, respectively. For the tenth quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock will be fixed at the rate in effect at the end of the ninth quarterly dividend period and after four and one-half years from its issuance the dividend rate will be fixed at 9 percent per annum. On September 28, 2012, Salisbury declared a Series B Preferred Stock dividend of $46,250, payable on October 1, 2012. The Series B Preferred Stock is non-voting, other than voting rights on matters that could adversely affect the Series B Preferred Stock. The Series B Preferred Stock is redeemable at any time at one hundred percent of the issue price plus any accrued and unpaid dividends.

Simultaneously with the receipt of the SBLF capital, Salisbury repurchased for $8,816,000 all of its Series A Preferred Stock sold to the Treasury in 2009 under the Capital Purchase Program ("CPP"), a part of the Troubled Asset Relief Program of the Emergency Economic Stabilization Act of 2008, and made a payment for accrued dividends. The transaction resulted in net capital proceeds to Salisbury of $7,184,000, of which Salisbury invested $6,465,600, or 90%, in the Bank as Tier 1 Capital.

In 2009, as part of the CPP, Salisbury issued to the Treasury a 10-year Warrant to purchase 57,671 shares of Common Stock at an exercise price of $22.93 per share. The Warrant was repurchased for $205,000 on November 2, 2011 and simultaneously cancelled.

NOTE 8 – PENSION AND OTHER BENEFITS

The components of net periodic cost for Salisbury's insured noncontributory defined benefit retirement plan were as follows:

	Three months		Nine months	
Periods ended September 30, (in thousands)	2012	2011	2012	2011
Service cost	$ 94	$ 67	$ 310	$ 258
Interest cost on benefit obligation	88	101	270	287
Expected return on plan assets	(113)	(102)	(342)	(314)
Amortization of net loss	28	23	95	56
Settlements and curtailments	-	-	341	-
Net periodic benefit cost	$ 97	$ 89	$ 674	$ 287

Salisbury's 401(k) Plan contribution expense was $70,000 and $75,000, respectively, for the three month periods ended September 30, 2012 and 2011. Other post-retirement benefit obligation expense for endorsement split-dollar life insurance arrangements was $11,000 and $12,000, respectively, for the three month periods ended September 30, 2012 and 2011.

NOTE 9 – COMPREHENSIVE INCOME

The components of accumulated other comprehensive income are as follows:

September 30, (in thousands)	2012	2011
Unrealized gains (losses) on securities available-for-sale, net of tax	$ 2,950	$ 1,480
Unrecognized pension plan expense, net of tax	(2,078)	(1,154)
Accumulated other comprehensive income (loss), net	$ 872	$ 326

NOTE 10 – FAIR VALUE OF ASSETS AND LIABILITIES

Salisbury uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, other assets are recorded at fair value on a nonrecurring basis, such as loans held for sale, collateral dependent impaired loans, property acquired through foreclosure or repossession and mortgage servicing rights. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

Salisbury adopted ASC 820-10, "Fair Value Measurements and Disclosures," which provides a framework for measuring fair value under generally accepted accounting principles, in 2008. This guidance permitted Salisbury the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. Salisbury did not elect fair value treatment for any financial assets or liabilities upon adoption.

In accordance with ASC 820-10, Salisbury groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

GAAP specifies a hierarchy of valuation techniques based on whether the types of valuation information ("inputs") are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Salisbury's market assumptions. These two types of inputs have created the following fair value hierarchy

- Level 1. Quoted prices in active markets for identical assets. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets.

Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

- Level 2. Significant other observable inputs. Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third-party pricing services for identical or comparable assets or liabilities.
- Level 3. Significant unobservable inputs. Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following is a description of valuation methodologies for assets recorded at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

- Securities available-for-sale. Securities available-for-sale are recorded at fair value on a recurring basis. Level 1 securities include exchange-traded equity securities. Level 2 securities include debt securities with quoted prices, which are traded less frequently than exchange-traded instruments, whose value is determined using matrix pricing with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes obligations of the U.S. Treasury and U.S. government-sponsored enterprises, mortgage-backed securities, collateralized mortgage obligations, municipal bonds, SBA bonds, corporate bonds and certain preferred equities. Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.
- Collateral dependent loans that are deemed to be impaired are valued based upon the fair value of the underlying collateral less costs to sell. Such collateral primarily consists of real estate and, to a lesser extent, other business assets. Management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values resulting from its knowledge of the property. Internal valuations are utilized to determine the fair value of other business assets. Collateral dependent impaired loans are categorized as Level 3.
- Other real estate owned acquired through foreclosure or repossession is adjusted to fair value less costs to sell upon transfer out of loans. Subsequently, it is carried at the lower of carrying value or fair value less costs to sell. Fair value is generally based upon independent market prices or appraised values of the collateral. Management adjusts appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property, and such property is categorized as Level 3.

Assets measured at fair value are as follows:

(in thousands)	Fair Value Measurements Using Level 1	Level 2	Level 3	Assets at fair value
September 30, 2012				
Assets at fair value on a recurring basis				
U.S. Treasury notes	$ -	$ 2,745	$ -	$ 2,745
U.S. Government agency notes	-	7,755	-	7,755
Municipal bonds	-	47,184	-	47,184
Mortgage-backed securities:				
U.S. Government agencies	-	46,761	-	46,761
Collateralized mortgage obligations:				
U.S. Government agencies	-	5,750	-	5,750
Non-agency	-	12,384	-	12,384
SBA bonds	-	3,032	-	3,032
Preferred stocks	54	-	-	54
Securities available-for-sale	$ 54	$ 125,611	$ -	$ 125,665
Assets at fair value on a non-recurring basis				
Collateral dependent impaired loans	$ -	$ -	$ 7,978	$ 7,978
Other real estate owned	-	-	641	641
December 31, 2011				
Assets at fair value on a recurring basis				
U.S. Treasury notes	$ -	$ 5,528	$ -	$ 5,528
U.S. Government agency notes	-	14,924	-	14,924
Municipal bonds	-	50,796	-	50,796
Mortgage-backed securities:				
U.S. Government agencies	-	58,300	-	58,300
Collateralized mortgage obligations:				
U.S. Government agencies	-	7,153	-	7,153
Non-agency	-	14,167	-	14,167
SBA bonds	-	3,706	-	3,706
Corporate bonds	-	1,104	-	1,104
Preferred stocks	116	-	-	116
Securities available-for-sale	$ 116	$ 155,678	$ -	$ 155,794
Assets at fair value on a non-recurring basis				
Collateral dependent impaired loans	$ -	$ -	$ 5,443	$ 5,443
Other real estate owned	-	-	2,744	2,744

Carrying values and estimated fair values of financial instruments are as follows:

(in thousands)	Carrying value	Estimated fair value	Fair value measurements using Level 1	Level 2	Level 3
September 30, 2012					
Financial Assets					
Cash and due from banks	$ 65,416	$ 65,416	$ 65,416	$ -	$ -
Securities available-for-sale	125,665	125,665	54	125,611	-
Federal Home Loan Bank stock	5,747	5,747	-	5,747	-
Loans held-for-sale	1,595	1,607	-	-	1,607
Loans receivable net	377,377	378,529	-	-	378,529
Accrued interest receivable	1,966	1,966	-	-	1,966
Financial Liabilities					
Demand (non-interest-bearing)	$ 90,064	$ 90,064	$ -	$ -	$ 90,064
Demand (interest-bearing)	66,535	66,535	-	-	66,535
Money market	136,512	136,512	-	-	136,512
Savings and other	100,462	100,462	-	-	100,462
Certificates of deposit	96,633	97,744	-	-	97,744
Deposits	490,206	491,317	-	-	491,317
FHLBB advances	42,392	46,580	-	-	46,580
Repurchase agreements	2,941	2,941	-	-	2,941
Accrued interest payable	218	218	-	-	218
December 31, 2011					
Financial Assets					
Cash and due from banks	$ 36,886	$ 36,886	$ 36,886	$ -	$ -
Securities available-for-sale	155,794	155,794	116	155,678	-
Security held-to-maturity	50	52	-	52	-
Federal Home Loan Bank stock	6,032	6,032	-	6,032	-
Loans held-for-sale	948	955	-	-	955
Loans receivable net	370,766	373,071	-	-	373,071
Accrued interest receivable	2,126	2,126	-	-	2,126
Financial Liabilities					
Demand (non-interest-bearing)	$ 82,202	$ 82,202	$ -	$ -	$ 82,202
Demand (interest-bearing)	66,332	66,332	-	-	66,332
Money market	124,566	124,566	-	-	124,566
Savings and other	94,503	94,503	-	-	94,503
Certificates of deposit	103,703	104,466	-	-	104,466
Deposits	471,306	472,069	-	-	472,069
FHLBB advances	54,615	58,808	-	-	58,808
Repurchase agreements	12,148	12,148	-	-	12,148
Accrued interest payable	271	271	-	-	271

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations of Salisbury and its subsidiary should be read in conjunction with Salisbury's Annual Report on Form 10-K for the year ended December 31, 2011.

BUSINESS

Salisbury Bancorp, Inc. ("Salisbury"), a Connecticut corporation, formed in 1998, is a bank holding company for Salisbury Bank and Trust Company ("Bank"), a Connecticut-chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. Salisbury's principal business consists of the business of the Bank. The Bank, formed in 1848, is engaged in customary banking activities, including general deposit taking and lending activities to both retail and commercial markets, and trust and wealth advisory services. The Bank conducts its banking business from eight full-service offices in the towns of Canaan, Lakeville, Salisbury and Sharon, Connecticut, South Egremont and Sheffield, Massachusetts, Millerton and Dover Plains, New York, and operates its trust and wealth advisory services from offices in Lakeville, Connecticut.

Critical Accounting Policies and Estimates

Salisbury’s consolidated financial statements follow GAAP as applied to the banking industry in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event.

Salisbury’s significant accounting policies are presented in Note 1 of Notes to Consolidated Financial Statements in Salisbury's 2011 Annual Report on Form 10-K for the year ended December 31, 2011 and, along with this Management’s Discussion and Analysis, provide information on how significant assets are valued in the financial statements and how those values are determined. Management believes that the following accounting estimates are the most critical to aid in fully understanding and evaluating Salisbury’s reported financial results, and they require management’s most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain.

The allowance for loan losses represents management’s estimate of credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet. Note 1 of Notes to Consolidated Financial Statements in Salisbury's 2011 Annual Report on Form 10-K for the period ended December 31, 2011 describes the methodology used to determine the allowance for loan losses. In addition, a discussion of the factors driving changes in the amount of the allowance for loan losses are included in the “Provision and Allowance for Loan Losses” section of Management’s Discussion and Analysis of this Quarterly Report.

Management evaluates goodwill and identifiable intangible assets for impairment annually using valuation techniques that involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates, which are used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affects their value or estimated lives, could have a material adverse impact on the results of operations.

Management evaluates securities for other-than-temporary impairment giving consideration to the extent to which the fair value has been less than cost, estimates of future cash flows, delinquencies and default severity, and the intent and ability of Salisbury to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The consideration of the above factors is subjective and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

The determination of the obligation and expense for pension and other postretirement benefits is dependent on certain assumptions used in calculating such amounts. Key assumptions used in the actuarial valuations include the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and health care costs.

Actual results could differ from the assumptions and market driven rates may fluctuate. Significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other postretirement obligations and expense.

RESULTS OF OPERATIONS

For the three month periods ended September 30, 2012 and 2011

Overview

Net income available to common shareholders was $1,094,000, or $0.65 per common share, for the quarter ended September 30, 2012 (third quarter 2012), versus $1,069,000, or $0.63 per common share, for the quarter ended June 30, 2012 (second quarter 2012), and $865,000, or $0.51 per common share, for the quarter ended September 30, 2011 (third quarter 2011).

- Earnings per common share increased $0.02, or 3.2%, to $0.65 versus second quarter 2012, and increased $0.14, or 27.5%, versus third quarter 2011.
- Tax equivalent net interest income decreased $121,000, or 2.5%, versus second quarter 2012, and decreased $80,000, or 1.64%, versus third quarter 2011.
- Provision for loan losses was $330,000, versus $180,000 second quarter 2012 and third quarter 2011 respectively.
- Net loan charge-offs were $358,000, versus $138,000 second quarter 2012 and $132,000 third quarter 2011.
- Non-interest income decreased $3,000, or 0.2%, versus second quarter 2012 and increased $553,000, or 41.5%, versus third quarter 2011. Second quarter 2012 included a $267,000 securities gain.
- Non-interest expense decreased $333,000, or 6.6%, versus second quarter 2012 and increased $158,000, or 3.5%, versus third quarter 2011. Third quarter 2012 included non-recurring litigation expense of $150,000. Second quarter 2012 included a pension plan curtailment expense of $341,000 and litigation expenses of $294,000, of which $250,000 was non-recurring.
- Preferred stock dividends paid were $46,000, versus $48,000 second quarter 2012 and $228,000 third quarter 2011.
- Non-performing assets increased $1.5 million, or 17.4%, to $9.9 million, or 1.6% of total assets, at September 30, 2012 versus June 30, 2012 and decreased $4.1 million versus September 30, 2011. Accruing loans receivable

30-to-89 days past due increased $0.7 million to $3.2 million, or 0.83% of gross loans receivable, at September 30, 2012 versus June 30, 2012 and increased $0.8 million versus September 30, 2011.

Net Interest Income

Tax equivalent net interest income decreased $121,000, or 2.5%, versus second quarter 2012, and decreased $80,000, or 1.6%, versus third quarter 2011. Average total interest bearing deposits increased $14.0 million as compared with second quarter 2012 and increased $14.4 million, or 3.7%, as compared with third quarter 2011. Average earning assets increased $14.3 million as compared with second quarter 2012 and increased $4.6 million, or 0.8%, as compared with third quarter 2011. The net interest margin decreased 18 basis points versus second quarter 2012 and decreased 8 basis points versus third quarter 2011 to 3.35% for third quarter 2012.

The following table sets forth the components of Salisbury's tax-equivalent net interest income and yields on average interest-earning assets and interest-bearing funds.

Three months ended September 30,	Average Balance		Income / Expense		Average Yield / Rate	
(dollars in thousands)	2012	2011	2012	2011	2012	2011
Loans (a)	$383,953	$367,681	$ 4,501	$ 4,630	4.69%	5.03%
Securities (c)(d)	129,945	139,608	1,303	1,549	4.01	4.44
FHLBB stock	5,747	6,032	8	5	0.51	0.36
Short term funds (b)	52,461	54,159	25	30	0.19	0.22
Total earning assets	572,106	567,480	5,837	6,214	4.08	4.37
Other assets	40,220	35,066				
Total assets	$612,326	$602,546				
Interest-bearing demand deposits	$ 65,813	$ 65,906	78	108	0.47	0.65
Money market accounts	136,865	117,812	104	128	0.30	0.43
Savings and other	102,039	97,330	67	95	0.26	0.39
Certificates of deposit	97,354	106,627	331	417	1.35	1.55
Total interest-bearing deposits	402,071	387,675	580	748	0.57	0.77
Repurchase agreements	3,596	15,439	3	19	0.29	0.50
FHLBB advances	42,533	55,175	452	565	4.16	4.01
Total interest-bearing liabilities	448,200	458,289	1,035	1,332	0.92	1.15
Demand deposits	89,225	79,599				
Other liabilities	4,808	3,238				
Shareholders' equity	70,093	61,420				
Total liabilities & shareholders' equity	$612,326	$602,546				
Net interest income			$ 4,802	$ 4,882		
Spread on interest-bearing funds					3.16	3.22
Net interest margin (e)					3.35	3.43

(a) *Includes non-accrual loans.*

(b) *Includes interest-bearing deposits in other banks and federal funds sold.*

(c) *Average balances of securities are based on historical cost.*

(d) *Includes tax exempt income benefit of $229,000 and $258,000, respectively for 2012 and 2011 on tax-exempt securities whose income and yields are calculated on a tax-equivalent basis.*

(e) *Net interest income divided by average interest-earning assets.*

The following table sets forth the changes in tax-equivalent interest due to volume and rate.

Three months ended September 30, (in thousands)	2012 versus 2011		
Change in interest due to	Volume	Rate	Net
Interest-earning assets			
Loans	$ 198	$ (327)	$ (129)
Securities	(102)	(144)	(246)
FHLBB stock	-	3	3
Short term funds	(1)	(4)	(5)
Total	95	(472)	(377)
Interest-bearing liabilities			
Deposits	(12)	(156)	(168)
Repurchase agreements	(12)	(4)	(16)
FHLBB advances	(132)	19	(113)
Total	(156)	(141)	(297)
Net change in net interest income	$ 251	$ (331)	$ (80)

Interest Income

Tax equivalent interest income decreased $377,000, or 6.1%, to $5.8 million for third quarter 2012 as compared with third quarter 2011. Loan income decreased $129,000, or 2.8%, primarily due to a 34 basis points decline in the average loan yield offset in part by a $16.3 million, or 4.3%, increase in average loans. Tax equivalent securities income decreased $246,000, or 15.6%, primarily due to a 43 basis points decline in the average yield and by a $9.7 million, or 6.9%, decrease in average volume. Changes in securities yields resulted from the effect of changes in market interest rates on securities purchases, calls of agency bonds and prepayments of mortgage backed securities. Income from short term funds decreased $5,000 as a result of a 3 basis points decline in the average yield and by a $1.7 million decrease in the average balance.

Interest Expense

Interest expense decreased $297,000, or 22.3%, to $1.0 million for third quarter 2012 as compared with third quarter 2011. Interest on deposit accounts and retail repurchase agreements decreased $184,000, or 2.4%, as a result of lower average rates, down 20 and 21 basis points respectively. Lower rates were offset in part by a $2.6 million, or 0.6%, increase in the average balance of deposits and repurchase agreements. The lower average rate resulted from the effect of lower market interest rates on rates paid and changes in product mix. The higher average volume resulted from deposit growth. Interest expense on FHLBB borrowings decreased $113,000 as a result of lower average borrowings, down $12.6 million, offset partially by an average borrowing rate increase of 15 basis points as compared with third quarter 2011. The decline in advances resulted from scheduled maturities that were not replaced with new advances.

Provision and Allowance for Loan Losses

The provision for loan losses was $330,000 for third quarter 2012 and $180,000 for third quarter 2011. Net loan charge-offs were $358,000 and $132,000, for the respective quarters. The following table sets forth changes in the allowance for loan losses and other selected statistics:

	Three months		Nine months	
Periods ended September 30, (dollars in thousands)	2012	2011	2012	2011
Balance, beginning of period	$ 4,208	$ 3,979	$ 4,076	$ 3,920
Provision for loan losses	330	180	690	860
Charge-offs				
Real estate mortgages	(354)	(155)	(532)	(531)
Commercial & industrial	-	-	(29)	(89)
Consumer	(14)	(10)	(63)	(188)
Total charge-offs	(368)	(165)	(624)	(808)
Recoveries				
Real estate mortgages	3	1	7	4
Commercial & industrial	1	29	9	29
Consumer	5	3	21	22
Total recoveries	9	33	37	55
Net charge-offs	(359)	(132)	(587)	(753)
Balance, end of period	$ 4,179	$ 4,027	$ 4,179	$ 4,027
Loans receivable, gross			$380,508	$365,961
Non-performing loans			9,229	13,911
Accruing loans past due 30-89 days			3,152	2,398
Ratio of allowance for loan losses:				
to loans receivable, gross			1.10%	1.10%
to non-performing loans			45.28	28.95
Ratio of non-performing loans to loans receivable, gross			2.43	3.80

Ratio of accruing loans past due 30-89 days to loans receivable, gross	0.83	0.66

Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, remained unchanged at 1.10% at September 30, 2012, June 30, 2012 and September 30, 2011.

During the first nine months of 2012, non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) increased $1.2 million to $9.2 million, or 2.43% of gross loans receivable, from 2.16% at December 31, 2011. Compared with a year ago non-performing loans decreased $4.7 from 3.80% of gross loans receivable at September 30, 2011. Accruing loans past due 30-89 days increased $0.8 million to 0.83% of gross loans receivable, from 0.66% at December 31, 2011 and 0.66% at September 30, 2011. See "Financial Condition – Loan Credit Quality" for further discussion and analysis.

The credit quality segments of loans receivable and the allowance for loan losses are as follows:

(in thousands)	September 30, 2012		December 31, 2011	
	Loans	Allowance	Loans	Allowance
Performing loans	$ 351,971	$ 2,426	$ 346,303	$ 2,436
Potential problem loans	9,630	289	7,289	234
Collectively evaluated	361,601	2,715	353,592	2,670
Performing loans	391	90	819	35
Potential problem loans	2,480	61	6,750	255
Impaired loans	16,036	920	12,677	874
Individually evaluated	18,907	1,071	20,246	1,164
Unallocated allowance	-	393	-	242
Totals	$ 380,508	$ 4,179	$ 373,838	$ 4,076

The allowance for loan losses represents management's estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan or portion of a loan to be uncollectible. The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans are segmented into pools of loans based on similar risk characteristics such as loan product, collateral type and loan-to-value, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Impaired loans and certain potential problem loans, where warranted, are individually evaluated for impairment. Impairment is measured for each individual loan, or for a borrower's aggregate loan exposure, using either the fair value of the collateral if the loan is collateral dependent or the present value of expected future cash flows discounted at the loan's effective interest rate. An allowance is established when the collateral value or discounted cash flows of the loan is lower than the carrying value of that loan.

The component of the allowance for loan losses for loans collectively evaluated for impairment is estimated by stratifying loans into segments and credit risk ratings and applying management's general loss allocation factors. The general loss allocation factors are based on expected loss experience adjusted for historical loss experience and other qualitative factors, including levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. The qualitative factors are determined based on the various risk characteristics of each loan segment. There were no significant changes in Salisbury's policies or methodology pertaining to the general component of the allowance for loan losses during the quarter ended September 30, 2012.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management’s estimate of probable losses. It reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Determining the adequacy of the allowance at any given period is difficult, particularly during deteriorating or uncertain economic periods, and management must make estimates using assumptions and information that are often subjective and changing rapidly. The review of the loan portfolio is a continuing event in light of a changing economy and the dynamics of the banking and regulatory environment. Should the economic climate deteriorate, borrowers could experience difficulty and the level of non-performing loans, charge-offs and delinquencies could rise and require increased provisions. In management's judgment, Salisbury remains adequately reserved both against total loans and non-performing loans at September 30, 2012.

Management’s loan risk rating assignments, loss percentages and specific reserves are subjected annually to an independent credit review by an external firm. In addition, the bank is examined annually on a rotational process by one of its two primary regulatory agencies, the FDIC and State of Connecticut Department of Banking (“CTDOB”). As an integral part of their examination process, the FDIC and CTDOB review the Bank's credit risk ratings and allowance for loan losses. The Bank was examined by the CTDOB in July 2012 and by the FDIC in May 2011.

Non-interest income

The following table details the principal categories of non-interest income.

Three months ended September 30, (dollars in thousands)	2012	2011	2012 vs. 2011	
Trust and wealth advisory fees	$ 683	$ 599	$ 84	14.02%
Service charges and fees	559	534	25	4.68
Gains on sales of mortgage loans, net	568	178	390	219.10
Mortgage servicing, net	(9)	(35)	26	(74.29)
Gains on securities, net	-	-	-	-
Other	86	58	28	48.28
Total non-interest income	$ 1,887	$ 1,334	$ 553	41.45%

Non-interest income for third quarter 2012 increased $553,000 versus third quarter 2011. Trust and Wealth Advisory revenues increased $84,000 due primarily from growth in managed assets. Service charges and fees increased $25,000 mainly due to increased debit card interchange fees. Income from sales and servicing of mortgage loans increased $416,000 due to interest rate driven fluctuations in the volume of fixed rate residential mortgage loan sales and mortgage servicing valuations. Mortgage loans sales totaled $18.3 million for third quarter 2012 versus $7.6 million for third quarter 2011. Third quarter 2012 and third quarter 2011 included a mortgage servicing valuation impairment benefit of $12,000 and charge of $65,000 respectively. The increase in other income consisted primarily of bank owned life insurance income.

Non-interest expense

The following table details the principal categories of non-interest expense.

Three months ended September 30, (dollars in thousands)	2012	2011	2012 vs. 2011	
Salaries	$ 1,810	$ 1,816	$ (6)	(0.33)%
Employee benefits	597	636	(39)	(6.13)
Premises and equipment	603	582	21	3.61
Data processing	369	366	3	0.82
Professional fees	299	307	(8)	(2.61)
Collections and OREO	301	152	149	98.03
FDIC insurance	116	137	(21)	(15.33)
Marketing and community contributions	92	85	7	8.24
Amortization of intangible assets	56	56	-	-
Other	450	398	52	13.07
Total non-interest expense	$ 4,693	$ 4,535	$ 158	3.48%

Non-interest expense for third quarter 2012 increased $158,000 versus third quarter 2011. Compensation and employee benefits decreased $45,000 due to changes in staffing levels and mix. Premises and equipment increased $21,000 due primarily to increased machine and software maintenance, due to replaced and upgraded equipment and software, offset slightly by an expense for disposed assets in third quarter 2011.

Data processing increased $3,000. Higher volume of debit card and ATM transactions was partially offset by lower core processing expenses. Professional fees decreased $8,000. Lower usage of legal and consulting fees was partially offset by higher investment management fees due to increased assets under management in the Trust and Wealth Advisory division. Collections and OREO increased $149,000 versus third quarter 2011 due primarily to increased litigation expenses. FDIC insurance decreased $21,000 due to a decrease in the assessment base. Marketing and other operating expenses increased $59,000 due to higher administrative and operational expenses.

Income taxes

The effective income tax rates for third quarter 2012, second quarter 2012 and third quarter 2011 were 20.63%, 18.54% and 16.43%, respectively. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Salisbury's effective tax rate is generally less than the 34% federal statutory rate due to holdings of tax-exempt municipal bonds, some tax-exempt loans and bank owned life insurance.

Salisbury did not incur Connecticut income tax in 2012 or 2011, other than minimum state income tax, as a result of its utilization of Connecticut tax legislation that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company ("PIC"). In accordance with this legislation, in 2004 the Bank formed a PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation. Salisbury does not expect to pay other than minimum state income tax in the foreseeable future unless there is a change in the State of Connecticut corporate tax law.

For the nine month periods ended September 30, 2012 and 2011

Overview

Net income available to common shareholders was $3,328,000, or $1.97 per common share, for the nine month period ended September 30, 2012 (nine month period 2012), compared with $2,459,000, or $1.46 per common share, for the nine month period ended September 30, 2011 (nine month period 2011).

- Earnings per common share increased $0.51, or 34.9%, to $1.97 versus nine month period 2011.
- Tax equivalent net interest income increased $133,000, or 0.9%, to $14.7 million, versus nine month period 2011.
- Provision for loan losses was $690,000, versus $860,000 for nine month period 2011. Net loan charge-offs were $587,000, versus $753,000 for nine month period 2011.
- Non-interest income increased $1,472,000, or 37.12%, versus nine month period 2011. Nine month period 2012 included a $267,000 securities gain.
- Non-interest expense increased $830,000, or 6.20%, versus nine month period 2011. Nine month period 2012 included a pension plan curtailment expense of $341,000 and litigation expenses of $533,000, of which $400,000 was non-recurring.

Net Interest Income

Tax equivalent net interest income for nine month period 2012 increased $133,000, or 0.9%, versus nine month period 2011. The net interest margin decreased 4 basis points to 3.47% from 3.51%.

The following table sets forth the components of Salisbury's tax-equivalent net interest income and yields on average interest-earning assets and interest-bearing funds.

Nine months ended September 30,	Average Balance		Income / Expense		Average Yield / Rate	
(dollars in thousands)	2012	2011	2012	2011	2012	2011
Loans (a)	$381,429	$366,198	$ 13,678	$ 13,989	4.78%	5.10%
Securities (c)(d)	139,719	141,237	4,190	4,686	4.00	4.42
FHLBB stock	5,819	6,032	23	18	0.52	0.40
Short term funds (b)	36,526	37,786	53	96	0.19	0.34
Total earning assets	563,493	551,253	17,944	18,789	4.25	4.55
Other assets	40,392	34,197				
Total assets	$603,885	$585,450				
Interest-bearing demand deposits	$ 66,058	$ 63,833	276	331	0.56	0.69

Money market accounts	127,991	103,820	324	397	0.34	0.51
Savings and other	99,003	96,515	219	289	0.30	0.40
Certificates of deposit	99,944	113,364	1,051	1,432	1.41	1.69
Total interest-bearing deposits	392,996	377,532	1,870	2,449	0.64	0.87
Repurchase agreements	6,863	12,339	21	46	0.41	0.50
FHLBB advances	44,140	57,924	1,398	1,772	4.16	4.03
Total interest-bearing liabilities	443,999	447,795	3,289	4,267	0.99	1.27
Demand deposits	86,420	76,121				
Other liabilities	4,487	3,653				
Shareholders' equity	68,979	57,881				
Total liabilities & shareholders' equity	$603,885	$585,450				
Net interest income			$ 14,655	$ 14,522		
Spread on interest-bearing funds					3.26	3.28
Net interest margin (e)					3.47	3.51

(a) *Includes non-accrual loans.*

(b) *Includes interest-bearing deposits in other banks and federal funds sold.*

(c) *Average balances of securities are based on historical cost.*

(d) *Includes tax exempt income benefit of $713,000 and $775,000, respectively for 2012 and 2011 on tax-exempt securities whose income and yields are calculated on a tax-equivalent basis.*

(e) *Net interest income divided by average interest-earning assets.*

The following table sets forth the changes in tax-equivalent interest due to volume and rate.

Nine months ended September 30, (in thousands)	2012 versus 2011		
Change in interest due to	Volume	Rate	Net
Interest-earning assets			
Loans	$ 564	$ (875)	$ (311)
Securities	(48)	(448)	(496)
FHLBB stock	(1)	6	5
Short term funds	(3)	(40)	(43)
Total	512	(1,357)	(845)
Interest-bearing liabilities			
Deposits	(62)	(517)	(579)
Repurchase agreements	(19)	(6)	(25)
FHLBB advances	(429)	55	(374)
Total	(510)	(468)	(978)
Net change in net interest income	$ 1,022	$ (889)	$ 133

Interest Income

Tax equivalent interest income decreased $845,000, or 4.5%, to $17.9 million for nine month period 2012 versus nine month period 2011.

Loan income decreased $311,000, or 2.2%, primarily due to a 32 basis points decline in the average loan yield offset in part by a $15.2 million, or 4.2%, increase in average loans. Tax equivalent securities income decreased $496,000, or 10.6%, primarily due to a 42 basis points decline in the average yield and by a $1.5 million, or 1.1%, decrease in average volume. Changes in securities yields resulted from the effect of changes in market interest rates on securities purchases, calls and sales of agency bonds and prepayments of mortgage backed securities. Income from short term funds decreased $43,000 as a result of a 15 basis points decline in the average yield and by a $1.3 million decrease in the average balance.

Interest Expense

Interest expense decreased $978,000, or 22.9%, to $3.3 million for nine month period 2012 versus nine month period 2011.

Interest on deposit accounts and retail repurchase agreements decreased $604,000, or 24.2%, as a result of lower average rates, down 23 and 9 basis points respectively, along with an average balance decrease of $5.5 million in repurchase agreements. Lower rates were offset in part by a $15.5 million, or 4.1%, increase in the average balance of deposits. The lower average rate resulted from the effect of lower market interest rates on rates paid and changes in product mix. The higher average volume resulted from deposit growth.

Interest expense on FHLBB borrowings decreased $374,000 as a result of lower average borrowings, down $13.8 million, offset in part by a higher average borrowing rate, up 13 basis points, due to scheduled maturities that were not replaced with new advances.

Provision and Allowance for Loan Losses

The provision for loan losses was $690,000 for nine month period 2012 and $860,000 for nine month period 2011. Net loan charge-offs were $587,000 and $753,000, for the respective periods.

Reserve coverage at September 30, 2012, as measured by the ratio of allowance for loan losses to gross loans, remained stable at 1.10%, as compared with 1.10% a year ago at September 30, 2011. During the first nine months of 2012, non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) increased $1.2 million to $9.2 million, or 2.43% of gross loans receivable, from 2.16% at December 31, 2011 while accruing loans past due 30-89 days increased $0.7 million to $3.2 million, or 0.83% of gross loans receivable from 0.66% at December 31, 2011. See “Financial Condition – Loan Credit Quality” for further discussion and analysis.

Non-interest income

The following table details the principal categories of non-interest income.

Nine months ended September 30, (dollars in thousands)	2012	2011	2012 vs. 2011	
Trust and wealth advisory fees	$ 2,173	$ 1,861	$ 312	16.77%
Service charges and fees	1,628	1,555	73	4.69
Gains on sales of mortgage loans, net	1,203	370	833	225.14
Mortgage servicing, net	(98)	(8)	(90)	(1,125.00)
Gains on securities, net	279	11	268	2436.36
Other	252	176	76	43.18
Total non-interest income	$ 5,437	$ 3,965	$ 1,472	37.12%

Non-interest income for the nine month period 2012 increased $1,472,000 versus nine month period 2011. Trust and Wealth Advisory revenues increased $312,000 from growth in managed assets and higher estate fees collected in 2012. Service charges and fees increased $73,000 due primarily to higher interchange fees resulting from increased volume. Income from sales and servicing of mortgage loans increased $743,000 due to interest rate driven fluctuations in the volume of fixed rate residential mortgage loan sales and mortgage servicing valuations. Mortgage loans sales totaled $46.8 million for nine month period 2012 and $16.1 million for nine month period 2011. Nine month period 2012 and 2011 included mortgage servicing valuation impairment charges of $90,000 and $80,000, respectively. Nine month period 2012 gains on securities resulted from the sale of $2.5 million of US Treasury bonds, while nine month period 2011 gains on securities represent accretion of discounts on called securities. Other income consisted of bank owned life insurance income and rental income.

Non-interest expense

The following table details the principal categories of non-interest expense.

Nine months ended September 30, (dollars in thousands)	2012	2011	2012 vs. 2011	
Salaries	$ 5,268	$ 5,202	$ 66	1.27%
Employee benefits	2,244	1,919	325	16.94
Premises and equipment	1,799	1,733	66	3.81
Data processing	1,190	1,028	162	15.76
Professional fees	915	887	28	3.16
Collections and OREO	767	541	226	41.77
FDIC insurance	363	519	(156)	(30.06)
Marketing and community contributions	267	245	22	8.98
Amortization of intangible assets	167	167	-	-
Other	1,240	1,149	91	7.92
Non-interest expense	$ 14,220	$ 13,390	$ 830	6.20%

Non-interest expense for nine month period 2012 increased $830,000 versus nine month period 2011. Salaries increased $66,000 due to changes in staffing levels and mix. Employee benefits increased $325,000 due primarily to a 2012 pension plan curtailment expense of $341,000 from retiree lump-sum withdrawals. Premises and equipment increased $66,000 due primarily to higher depreciation and increased machine and software maintenance due to replaced and upgraded equipment and software. The increase was offset slightly by lower building maintenance and repairs (snow removal) and utilities due to the mild winter experienced in the Northeast. Data processing increased $162,000 due primarily to a 2011 vendor rebate and a higher volume of debit card and ATM transactions in 2012. Professional fees increased $28,000 due primarily to higher investment management fees associated with the growth in trust and wealth advisory assets under management and offset partially by lower usage of legal and consulting services. Collections and OREO expense increased $226,000 due primarily to higher litigation expenses, up $413,000, and payment of delinquent real estate taxes in connection with foreclosed properties, up $65,000. These increases were offset in part by lower foreclosed property expenses, which was down $217,000. Salisbury had $641,000 in foreclosed property at September 30, 2012 as compared with $2.7 million at September 30, 2011. FDIC insurance expense decreased $156,000 for the nine month period ended September 30, 2012, due primarily to a change in the basis of assessment effective July 1, 2011 that lowered the overall assessment rate for subsequent periods. Other operating expenses increased $113,000 due to higher other administrative and operational expenses.

Income taxes

The effective income tax rates for nine month periods 2012 and 2011 were 21.54% and 17.27%, respectively. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Salisbury's effective tax rate is generally less than the 34% federal statutory rate due to holdings of tax-exempt municipal bonds, some tax-exempt loans and bank owned life insurance.

FINANCIAL CONDITION

Overview

Total assets were $611 million at September 30, 2012, up $2 million from December 31, 2011. Loans receivable, net, were $377 million at September 30, 2012, up $6.6 million, or 1.8%, from December 31, 2011. Non-performing assets were $9.9 million at September 30, 2012, down $0.9 million from $10.8 million at December 31, 2011. Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, was 1.10%, 1.09% and 1.10%, at September 30, 2012, December 31, 2011 and September 30, 2011, respectively. Deposits were $490 million, up $19 million from $471 million at December 31, 2011.

At September 30, 2012, book value and tangible book value per common share were $32.18 and $25.86, respectively as compared with $30.12 and $23.69, respectively, at December 31, 2011 and $30.36 and $23.91, respectively, at September 30, 2011. Salisbury's Tier 1 leverage and total risk-based capital ratios were 9.78% and 17.00%, respectively, and above the "well capitalized" limits as defined by the FRB.

Securities and Short Term Funds

During third quarter 2012, securities decreased $30.5 million to $131 million, while cash and cash-equivalents (interest-bearing deposits with other banks, money market funds and federal funds sold) increased $28.5 million to $65 million. Salisbury continued to maintain a relatively high level of cash and cash-equivalents in response to historically low market interest rates and a higher level of volatile deposits.

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

Salisbury does not intend to sell any of its securities and it is not more likely than not that Salisbury will be required to sell any of its securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider any of its securities, other than four non-agency CMO securities reflecting OTTI, to be OTTI at September 30, 2012.

In 2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of $1.1 million. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of September 30, 2012. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis.

Accumulated other comprehensive income of $0.9 million at September 30, 2012 included net unrealized securities gains, net of tax, of $3.0 million, mostly offset by unrecognized pension plan expense, net of tax, of $2.1 million.

Loans

Net loans receivable increased $6.6 million during the first nine months of 2012 to $377.4 million at September 30, 2012, compared with $370.8 million at December 31, 2011.

The composition of loans receivable and loans held-for-sale is as follows:

(in thousands)	September 30, 2012	December 31, 2011
Residential 1-4 family	$ 196,976	$ 187,676
Residential 5+ multifamily	3,604	3,187
Construction of residential 1-4 family	4,044	5,305
Home equity credit	35,263	34,621
Residential real estate	239,887	230,789
Commercial	83,219	81,958
Construction of commercial	5,416	7,069
Commercial real estate	88,635	89,027
Farm land	4,364	4,925
Vacant land	11,172	12,828
Real estate secured	344,058	337,569
Commercial and industrial	28,893	29,358
Municipal	3,083	2,415
Consumer	4,474	4,496
Loans receivable, gross	380,508	373,838
Deferred loan origination fees and costs, net	1,048	1,004
Allowance for loan losses	(4,179)	(4,076)
Loans receivable, net	$ 377,377	$ 370,766
Loans held-for-sale		
Residential 1-4 family	$ 1,595	$ 948

Loan Credit Quality

The persistent weakness in the local and regional economies continues to impact the credit quality of Salisbury's loans receivable. During the first nine months of 2012, while non-performing assets decreased $0.9 million, total impaired and potential problem loans increased $1.4 million to $28.1 million, or 7.4% of gross loans receivable at September 30, 2012, from $26.7 million, or 7.2% of gross loans receivable at December 31, 2011.

The credit quality segments of loans receivable and their credit risk ratings are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Pass	$ 318,822	$ 314,551
Special mention	33,540	32,570
Performing loans	352,362	347,121
Substandard	12,110	14,039
Potential problem loans	12,110	14,039
Pass		
Troubled debt restructured loans, accruing	1,131	1,379
Special mention		
Troubled debt restructured loans, accruing	1,579	1,413
Substandard		
Troubled debt restructured loans, accruing	4,097	1,810
Troubled debt restructured loans, non-accrual	1,962	1,753
All other non-accrual loans	7,267	6,323
Impaired loans	16,036	12,678
Loans receivable, gross	$ 380,508	$ 373,838

Changes in impaired and potential problem loans are as follows:

Nine months ended (in thousands)	September 30, 2012				September 30, 2011			
	Impaired loans		Potential	Total	Impaired loans		Potential	Total
	Non-accrual	Accruing	problem loans		Non-accrual	Accruing	problem loans	
Loans placed on non-accrual status	$ 3,858	$ (665)	$ (1,099)	$ 2,094	$ 5,684	$ (2,797)	$ (2,268)	$ 619
Loans restored to accrual status	(887)	563	23	(301)	-	-	-	-
Loan risk rating downgrades to substandard	-	-	1,680	1,680	-	-	11,190	11,190
Loan risk rating upgrades from substandard	-	-	(402)	(402)	-		(1,950)	(1,950)
Loan repayments	(596)	(155)	(301)	(1,052)		(33)	(405)	(438)
Loan charge-offs	(556)	-	-	(556)	(774)	(30)	-	(804)
Increase (decrease) in TDR loans	-	2,463	(1,830)	633	(731)	(417)	-	(1,148)
Real estate acquired in settlement of loans	(666)	-	-	(666)	(314)	-	-	(314)
Increase (decrease) in loans	$ 1,153	$ 2,206	$ (1,929)	$ 1,430	$ 3,865	$ (3,277)	$ 6,567	$ 7,155

During the first nine months of 2012 Salisbury downgraded risk ratings on $1.7 million of loans, placed $3.9 million of loans on non-accrual status as a result of deteriorated payment and financial performance and charged-off $556,000 of losses primarily as a result of collateral deficiencies. Offsetting these deteriorations were loan risk rating upgrades resulting from improved performance, loans returned to accrual status as a result of sustained performance, and loan repayments.

Salisbury has cooperative relationships with the vast majority of its non-performing loan customers. Substantially all non-performing loans are collateralized with real estate and the repayment of such loans is largely dependent on the return of such loans to performing status or the liquidation of the underlying real estate collateral. Salisbury pursues the resolution of non-performing loans through collections, restructures, voluntary liquidation of collateral by the borrower and, where necessary, legal action. When reasonable attempts to work with a customer to return a loan to performing status, including restructuring the loan, are unsuccessful, Salisbury initiates appropriate legal action seeking to acquire property by deed in lieu of foreclosure or through foreclosure, or to liquidate business assets.

The loan portfolio of Salisbury is substantially secured by real estate collateral and during the economic decline which began in 2007, the value and liquidity of real estate collateral in the region was generally negatively impacted. Recently, it appears that the real estate values in the markets in which Salisbury operates have generally stabilized and improvement in the value and liquidity of real estate collateral provides additional support for the adequacy of allowance for loan losses.

Credit Quality Segments

Salisbury categorizes loans receivable into the following credit quality segments.

- Impaired loans consist of all non-accrual loans and troubled debt restructured loans, and represent loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.
- Non-accrual loans, a sub-set of impaired loans, are loans for which the accrual of interest has been discontinued because, in the opinion of management, full collection of principal or interest is unlikely.
- Non-performing loans consist of non-accrual loans, and accruing loans past due 90 days and over that are well collateralized, in the process of collection and where full collection of principal and interest is assured. Non-performing assets consist of non-performing loans plus real estate acquired in settlement of loans.
- Troubled debt restructured loans are loans for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. Loan restructuring is employed when management believes the granting of a concession will increase the probability of the full or partial collection of principal and interest.
- Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and that are not classified as impaired.

Credit Risk Ratings

Salisbury assigns credit risk ratings to loans receivable in order to manage credit risk and to determine the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. Salisbury's rating model has eight risk rating grades, with each grade corresponding to a progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are ratings (special mention, substandard, doubtful and loss) defined by the bank's regulatory agencies, the FDIC and CTDOB. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.

- Loans risk rated as "special mention" possesses credit deficiencies or potential weaknesses deserving management's close attention that if left uncorrected may result in deterioration of the repayment prospects for the loans at some future date.
- Loans risk rated as "substandard" are loans where the Bank's position is clearly not protected adequately by borrower current net worth or payment capacity. These loans have well defined weaknesses based on objective evidence and include loans where future losses to the Bank may result if deficiencies are not corrected, and loans where the primary source of repayment such as income is diminished and the Bank must rely on sale of collateral or other secondary sources of collection.
- Loans risk rated as "doubtful" have the same weaknesses as substandard loans with the added characteristic that the weakness makes collection or liquidation in full, given current facts, conditions, and values, to be highly questionable and improbable. The possibility of loss is high, but due to certain important and reasonably specific pending factors,

which may work to strengthen the loan, its reclassification as an estimated loss is deferred until its exact status can be determined.

- Loans risk rated as "loss" are considered uncollectible and of such little value, that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be made in the future.

Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank's loan portfolio and risk ratings are examined annually on a rotating basis by its two primary regulatory agencies, the FDIC and CTDOB.

Impaired Loans

Impaired loans increased $3.4 million during first nine months of 2012 to $16.0 million, or 4.21% of gross loans receivable at September 30, 2012, from $12.7 million, or 3.39% of gross loans receivable at December 31, 2011. The components of impaired loans are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Troubled debt restructurings, accruing	$ 6,807	$ 4,602
Troubled debt restructuring, non-accrual	1,962	1,753
All other non-accrual loans	7,267	6,323
Impaired loans	$ 16,036	$ 12,678

Non-Performing Assets

Non-performing assets decreased $0.9 million during first nine months of 2012 to $9.9 million, or 1.62% of assets at September 30, 2012, from $10.8 million, or 1.78% of assets at December 31, 2011. The components of non-performing assets are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Residential 1-4 family	$ 1,158	$ 1,240
Home equity credit	299	173
Commercial	2,759	2,337
Vacant land	4,391	3,658
Real estate secured	8,607	7,408
Commercial and industrial	622	668
Consumer	-	-
Non-accruing loans	9,229	8,076
Accruing loans past due 90 days and over	-	-
Non-performing loans	9,229	8,076
Real estate acquired in settlement of loans "(OREO")	641	2,744
Non-performing assets	$ 9,870	$ 10,820

The past due status of non-performing loans is as follows:

(in thousands)	September 30, 2012	December 31, 2011
Current	$ 568	$ 734
Past due 001-029 days	-	138
Past due 030-059 days	721	134
Past due 060-089 days	1,004	-
Past due 090-179 days	634	1,095
Past due 180 days and over	6,302	5,975
Total non-performing loans	$ 9,229	$ 8,076

At September 30, 2012, 6.14% of non-accrual loans were current with respect to loan payments, compared with 9.09% at December 31, 2011. Loans past due 180 days include a $3.0 million loan secured by vacant land (residential building lots) where Salisbury has initiated a foreclosure action that is referred to in Item 1 of Part II, Legal Proceedings.

Troubled Debt Restructured Loans

Troubled debt restructured loans increased $2.4 million during the first nine months of 2012 to $8.8 million, or 2.31% of gross loans receivable at September 30, 2012, from $6.4 million, or 1.70% of gross loans receivable at December 31, 2011.

The components of troubled debt restructured loans are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Residential 1-4 family	$ 2,419	$ 2,163
Commercial	3,030	1,970
Real estate secured	5,449	4,133
Commercial and industrial	1,358	469
Accruing troubled debt restructured loans	6,807	4,602
Residential 1-4 family	323	52
Commercial	1,173	1,132
Vacant land	381	461
Real estate secured	1,877	1,645
Commercial and industrial	85	108
Non-accrual troubled debt restructured loans	1,962	1,753
Troubled debt restructured loans	$ 8,769	$ 6,355

The past due status of troubled debt restructured loans is as follows:

(in thousands)	September 30, 2012	December 31, 2011
Current	$ 5,811	$ 3,375
Past due 001-029 days	996	1,072
Past due 030-059 days	-	155
Accruing troubled debt restructured loans	6,807	4,602
Current	360	251
Past due 001-029 days	-	-
Past due 030-059 days	721	98
Past due 060-089 days	48	-
Past due 090-179 days	-	493
Past due 180 days and over	833	911
Non-accrual troubled debt restructured loans	1,962	1,753
Total troubled debt restructured loans	$ 8,769	$ 6,355

At September 30, 2012, 70.38% of troubled debt restructured loans were current with respect to loan payments, as compared with 57.06% at December 31, 2011.

Past Due Loans

Loans past due 30 days or more increased $2.2 million during first nine months of 2012 to $11.8 million, or 3.10% of gross loans receivable at September 30, 2012, compared with $9.7 million, or 2.59% of gross loans receivable at December 31, 2011.

The components of loans past due 30 days or greater are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Past due 030-059 days	$ 1,642	$ 1,999
Past due 060-089 days	1,510	461
Past due 090-179 days	-	-
Accruing loans	3,152	2,460
Past due 030-059 days	721	134
Past due 060-089 days	1,004	-
Past due 090-179 days	634	1,095
Past due 180 days and over	6,303	5,975
Non-accrual loans	8,662	7,204
Total loans past due 30 days or greater	$ 11,814	$ 9,664

Potential Problem Loans

Potential problem loans decreased $1.9 million during first nine months of 2012 to $12.1 million, or 3.19% of gross loans receivable at September 30, 2012, compared with $14.0 million, or 3.76% of gross loans receivable at December 31, 2011.

The components of potential problem loans are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Residential 1-4 family	$ 3,304	$ 3,367
Home equity credit	1,059	1,154
Residential real estate	4,363	4,521
Commercial	5,419	7,391
Construction of commercial	450	450
Commercial real estate	5,869	7,841
Farm land	1,191	830
Vacant land	188	249
Real estate secured	11,611	13,441
Commercial and Industrial	466	534
Consumer	33	64
Potential problem loans	$ 12,110	$ 14,039

The past due status of potential problem loans is as follows:

(in thousands)	September 30, 2012	December 31, 2011
Current	$ 10,023	$ 10,771
Past due 001-029 days	803	2,837
Past due 030-059 days	737	385
Past due 060-089 days	547	46
Past due 090-179 days	-	-
Total potential problem loans	$ 12,110	$ 14,039

At September 30, 2012, 82.77% of potential problem loans were current with respect to loan payments, as compared with 76.72% at December 31, 2011.

Management cannot predict the extent to which economic or other factors may impact such borrowers' future payment capacity, and there can be no assurance that such loans will not be placed on nonaccrual status, restructured, or require increased provision for loan losses.

Deposits and Borrowings

Deposits increased $12.3 million during third quarter 2012 to $490.2 million at September 30, 2012, versus $477.9 million at June 30, 2012, and increased $11.6 million versus $478.6 million at September 30, 2011. Retail repurchase agreements decreased $3.2 million during third quarter 2012 to $2.9 million at September 30, 2012, versus $6.1 million at June 30, 2012, and decreased $11.9 million versus $14.8 million at September 30, 2011.

Federal Home Loan Bank of Boston (FHLBB) advances decreased $0.4 million during third quarter 2012 to $42.4 million at September 30, 2012, versus $42.8 million at June 30, 2012, and decreased $12.6 million versus $55.0 million at September 30, 2011. The decreases were due to scheduled payments and maturities.

Liquidity

Salisbury manages its liquidity position to ensure it has sufficient funding availability to meet anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. Salisbury's primary sources of liquidity are principal payments and maturities of securities and loans, short-term borrowings through repurchase agreements and FHLBB advances, net deposit growth and funds provided by operations. Liquidity can also be provided through sales of loans and available-for-sale securities.

Salisbury manages its liquidity in accordance with a liquidity funding policy, and also maintains a contingency funding plan that provide for the prompt and comprehensive response to unexpected demands for liquidity. At September 30, 2012, Salisbury's liquidity ratio, as represented by cash, short term available-for-sale securities and marketable assets to net deposits and short term unsecured liabilities, was 35.0%, versus 33.7% at December 31, 2011. Management believes Salisbury's funding sources will meet its anticipated funding needs.

Operating activities for the nine month period 2012 provided net cash of $5.5 million. Investing activities provided net cash of $27.2 million, primarily $32.4 million from securities available-for-sale and $1.7 million from sales of other real estate owned, offset in part by $7.0 million in net loan advances. Financing activities utilized net cash of $4.1 million, primarily for FHLBB advance repayments of $12.2 million, dividends paid of $1.6 million, and a decrease of $16.3 million in time deposits and repurchase agreements, offset in part by a $26.0 million increase in deposit transaction accounts.

At September 30, 2012, Salisbury had outstanding commitments to fund new loan originations of $7.5 million and unused lines of credit of $52.2 million. Salisbury believes that these commitments can be met in the normal course of business. Salisbury believes that its liquidity sources will continue to provide funding sufficient to support operating activities, loan originations and commitments, and deposit withdrawals.

CAPITAL RESOURCES

Shareholders' equity was $70.4 million at September 30, 2012, up $3.5 million from December 31, 2011. Book value and tangible book value per common share were $32.18 and $25.86, respectively, compared with $30.12 and $23.69, respectively, at December 31, 2011. Contributing to the increase in shareholders' equity for nine month period 2012 was net income of $3.5 million, other comprehensive income of $1.6 million, less common and preferred stock dividends of $1.4 million and $0.2 million, respectively. Other comprehensive income included unrealized gains on securities available-for-sale, net of tax, of $3.0 million and unrealized losses on the pension plan income, net of tax, of $2.1 million.

In August 2011, Salisbury issued to the U.S. Secretary of the Treasury (the "Treasury") $16.0 million of its Series B Preferred Stock under the Small Business Lending Fund (the "SBLF") program. The SBLF program is a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion. The Preferred Stock qualifies as Tier 1 capital for regulatory purposes and ranks senior to the Common Stock.

The Series B Preferred Stock pays noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial quarterly dividend period ending June 30, 2011 and each of the next nine quarterly dividend periods the Series B Preferred Stock is outstanding is determined each quarter based on the increase in the Bank's Qualified Small Business Lending. The dividend rates for the quarters ended September 30, 2012 and December 31, 2011 were 1.15625% and 1.51925%, respectively. For the tenth quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock will be fixed at the rate in effect at the end of the ninth quarterly dividend period and after four and one-half years from its issuance the dividend rate will be fixed at 9 percent per annum. On September 28, 2012, Salisbury declared a Series B Preferred Stock dividend of $46,250, payable on October 1, 2012. The Series B Preferred Stock is non-voting, other than voting rights on matters that could adversely affect the Series B Preferred Stock. The Series B Preferred Stock is redeemable at any time at one hundred percent of the issue price plus any accrued and unpaid dividends.

Simultaneously with the receipt of the SBLF capital, Salisbury repurchased for $8,816,000 all of its Series A Preferred Stock sold to the Treasury in 2009 under the Capital Purchase Program ("CPP"), a part of the Troubled Asset Relief Program of the Emergency Economic Stabilization Act of 2008, and made a payment for accrued dividends. The transaction resulted in net capital proceeds to Salisbury of $7,184,000, of which Salisbury invested $6,465,600, or 90%, in the Bank as Tier 1 Capital.

In 2009, as part of the CPP, Salisbury issued to the Treasury a 10-year Warrant to purchase 57,671 shares of Common Stock at an exercise price of $22.93 per share. The Warrant was repurchased for $205,000 on November 2, 2011.

Capital Requirements

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Under current regulatory definitions, Salisbury and the Bank are considered to be "well capitalized" for capital adequacy purposes. As a result, the Bank pays lower federal deposit insurance premiums than banks that are not "well capitalized." Salisbury and the Bank's regulatory capital ratios are as follows:

	Well	September 30, 2012		December 31, 2011	
	capitalized	Salisbury	Bank	Salisbury	Bank
Total Capital (to risk-weighted assets)	10.00%	17.00%	14.05%	15.97%	13.16%
Tier 1 Capital (to risk-weighted assets)	6.00	15.86	12.92	14.88	12.08
Tier 1 Capital (to average assets)	5.00	9.78	8.07	9.45	7.77

A well-capitalized institution, which is the highest capital category for an institution as defined by the Prompt Corrective Action Regulations issued by the FDIC and the FRB, is one which maintains a Total Risk-Based ratio of 10% or above, a Tier 1 Risk-Based ratio of 6% or above and a Leverage ratio of 5% or above, and is not subject to any written order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level. Maintaining strong capital is essential to Salisbury's and the Bank's safety and soundness. However, the effective management of capital resources requires generating attractive returns on equity to build value for shareholders while maintaining appropriate levels of capital to fund growth, meet regulatory requirements and be consistent with prudent industry practices.

The Board of Governors of the Federal Reserve System and the other Federal Bank Supervisory Agencies recently proposed new regulations, which if adopted would restructure the current regulatory capital framework for the banking industry and revise the capital requirements applicable to banks and bank holding companies, including Salisbury and the Bank. These proposed capital rules would revise the risk-based and leverage capital ratios over time to implement the Dodd-Frank Act and to be generally consistent with Basel III Capital Standards established by the Basel Committee on Banking Supervision. The proposed rules would:

- Revise the definition of regulatory capital components and related calculations and revise certain methodologies for calculating risk weighted assets;
- Add a new minimum Common Equity Tier 1 risk based capital ratio of 4.5% of risk-weighted assets;
- Incorporate the revised regulatory capital requirements into the prompt corrective action framework;
- Implement a new capital conservation buffer; and
- Provide a transition period for several aspects of the proposed rule.

While the final provisions of such new capital regulations are uncertain, Salisbury has utilized available tools in an effort to reasonably assess the potential effect of these proposed capital rules on the adequacy of the capital ratios of both Salisbury and the Bank. Based upon such preliminary assessment, management has determined that Salisbury and the Bank have the ability to comply with the proposed capital regulations should they become effective.

Dividends

During the nine month period ended September 30, 2012 Salisbury paid $181,000 in Series B preferred stock dividends to the U.S. Treasury’s SBLF program, and $1,419,000 in common stock dividends.

Salisbury’s Board of Directors declared a $0.28 per common share quarterly cash dividend at their October 26, 2012 meeting. The dividend will be paid on November 30, 2012 to shareholders of record as of November 9, 2012.

Salisbury's ability to pay cash dividends is substantially dependent on the Bank's ability to pay cash dividends to Salisbury. Under Connecticut law a bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by a bank shall not, unless specifically approved by the Commissioner of Banking, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 27, 2009, notes that, as a general matter, the board of directors of a bank holding company (“BHC”) should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the FRB reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital structure.

Salisbury believes that the payment of common stock cash dividends is appropriate, provided that such payment considers Salisbury's capital needs, asset quality, and overall financial condition and does not adversely affect the financial stability of Salisbury or the Bank. The continued payment of common stock cash dividends by Salisbury will be dependent on Salisbury's and the Bank’s future core earnings, financial condition and capital needs, regulatory restrictions, and other factors deemed relevant by the Board of Directors of Salisbury.

IMPACT OF INFLATION AND CHANGING PRICES

Salisbury's consolidated financial statements are prepared in conformity with generally accepted accounting principles that require the measurement of financial condition and operating results in terms of historical dollars without considering changes in the relative purchasing power of money, over time, due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of Salisbury are monetary and as a result, interest rates have a greater impact on Salisbury's performance than do the effects of general levels of inflation, although interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Although not a material factor in recent years, inflation could impact earnings in future periods.

FORWARD-LOOKING STATEMENTS

This Form 10-Q and future filings made by Salisbury with the Securities and Exchange Commission, as well as other filings, reports and press releases made or issued by Salisbury and the Bank, and oral statements made by executive officers of Salisbury and the Bank, may include forward-looking statements relating to such matters as:

(a) assumptions concerning future economic and business conditions and their effect on the economy in general and on the markets in which Salisbury and the Bank do business; and
(b) expectations for revenues and earnings for Salisbury and the Bank.

Such forward-looking statements are based on assumptions and estimates rather than historical or current facts and, therefore, are inherently uncertain and subject to risk. For those statements, Salisbury claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Salisbury notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of Salisbury's and the Bank's business include the following:

(a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Bank operates;
(b) changes in the legislative and regulatory environment that negatively impacts Salisbury and Bank through increased operating expenses;
(c) increased competition from other financial and non-financial institutions;
(d) the impact of technological advances; and
(e) other risks detailed from time to time in Salisbury's filings with the Securities and Exchange Commission.

Such developments could have an adverse impact on Salisbury's and the Bank's financial position and results of operations.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Salisbury manages its exposure to interest rate risk through its Asset/Liability Management Committee ("ALCO") using risk limits and policy guidelines to manage assets and funding liabilities to produce financial results that are consistent with Salisbury's liquidity, capital adequacy, growth, risk and profitability targets. Interest rate risk is the risk of loss to future earnings due to changes in interest rates.

The ALCO manages interest rate risk using income simulation to measure interest rate risk inherent in Salisbury's financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over various time horizons. In management's September 30, 2012 analysis, all of the simulations incorporate management's growth assumption over the simulation horizons. Additionally, the simulations take into account the specific re-pricing, maturity and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios.

The ALCO reviews the simulation results to determine whether Salisbury's exposure to change in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. Salisbury's tolerance levels for changes in net interest income in its income simulations varies depending on the magnitude of interest rate changes and level of risk-based capital. All changes are measured in comparison to the projected net interest income that would result from an "unchanged" rate scenario where interest rates remain stable over the forecast horizon. The ALCO also evaluates the directional trends of net interest income, net interest margin and other financial measures over the forecast horizon for consistency with its liquidity, capital adequacy, growth, risk and profitability targets.

The ALCO uses multiple interest rate scenarios to evaluate interest risk exposure and may vary these interest rate scenarios to show the effect of steepening or flattening changes in yield curves as well as parallel changes in interest rates. At September 30, 2012 the ALCO used the following interest rate scenarios: (1) unchanged interest rates; (2) immediately rising interest rates – immediate non-parallel upward shift in market interest rates ranging from 300 basis points for short term rates to 275 basis points for the 10-year Treasury; (3) immediately falling interest rates – immediate non-parallel downward shift in market interest rates ranging from 25 basis points for short term rates to 65 basis points for the 10-year Treasury; and (4) A second immediately rising interest rates with assumption sensitivity stress testing; isolating key variables for impact on risk/return profile – immediate non-parallel upward shift in market interest rates ranging from 300 basis points for short term rates to 275 basis points for the 10-year Treasury. Deposit rates are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements. Further, deposits are assumed to have certain minimum rate levels below which they will not fall. Income simulations do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

As of September 30, 2012 net interest income simulations indicated that the Bank's exposure to changing interest rates over the simulation horizons remained within its acceptable strategic tolerance levels. The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for changes in market interest rates using the Bank's financial instruments as of September 30, 2012:

As of September 30, 2012	Months 1-12	Months 13-24
Immediately rising interest rates (management's growth assumptions)	(9.36)%	(8.08)%
Immediately falling interest rates (management's growth assumptions)	(1.04)	(2.63)
Gradually rising interest rates (management's growth assumptions)	(11.96)	(10.92)

The negative exposure of net interest income to immediately and gradually rising rates as compared to the unchanged rate scenario results from a faster projected rise in the cost of funds versus income from earning assets, as relatively rate-sensitive money market and time deposits re-price faster than longer duration earning assets. The negative exposure of net interest income to immediately falling rates as compared to an unchanged rate scenario results from a greater decline in earning asset yields compared to rates paid on funding liabilities, as a result of faster prepayments on existing assets and lower reinvestment rates on future loans originated and securities purchased.

While the ALCO reviews simulation assumptions and back-tests simulation results to ensure that they are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the re-pricing, maturity and prepayment characteristics of financial instruments and the composition of Salisbury's balance sheet may change to a different degree than estimated. Simulation modeling assumes Salisbury's expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. The assumed relationship between short-term interest rate changes and core deposit rate and balance changes used in income simulation may differ from the ALCO's estimates. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

Salisbury also monitors the potential change in market value of its available-for-sale debt securities in changing interest rate environments. The purpose is to determine market value exposure that may not be captured by income simulation, but which might result in changes to Salisbury's capital and liquidity position. Results are calculated using industry-standard analytical techniques and securities data. Available-for-sale equity securities are excluded from this analysis because the market value of such securities cannot be directly correlated with changes in interest rates. The following table summarizes the potential change in market value of available-for-sale debt securities resulting from immediate parallel rate shifts:

As of September 30, 2012 (in thousands)	Rates up 100bp	Rates up 200bp
U.S. Treasury notes	$(103)	$(201)
U.S. Government agency notes	(139)	(317)
Municipal bonds	(1,529)	(3,702)
Mortgage backed securities	(892)	(2,592)
Collateralized mortgage obligations	(504)	(1,029)
SBA pools	(9)	(17)
Total available-for-sale debt securities	$(3,176)	$(7,858)

Item 4. **CONTROLS AND PROCEDURES**

Evaluation of Disclosure Controls and Procedures

Salisbury's management, including its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of Salisbury's disclosure controls and procedures as of September 30, 2012. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective as of September 30, 2012.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that the information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports filed under the Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

In addition, based on an evaluation of its internal controls over financial reporting, no change in Salisbury's internal control over financial reporting occurred during the quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, Salisbury's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The Bank is involved in various claims and legal proceedings arising out of the ordinary course of business.

As previously disclosed, the Bank, individually and in its capacity as a former Co-Trustee of the Erling C. Christophersen Revocable Trust (the “Trust”), was named as a defendant in litigation filed in the Connecticut Complex Litigation Docket in Stamford, captioned John Christophersen v. Erling Christophersen, et al., X08-CV-08-5009597S (the “First Action”). The Bank also was a counterclaim-defendant in related mortgage foreclosure litigation in the Connecticut Complex Litigation Docket in Stamford, captioned Salisbury Bank and Trust Company v. Erling C. Christophersen, et al., X08-CV-10-6005847-S (the “Foreclosure Action,” together with the First Action, the “Actions”). The other parties to the Actions were John R. Christophersen; Erling C. Christophersen, individually and as Co-Trustee of the Trust; Bonnie Christophersen and Elena Dreiske, individually and as Co-Trustees of the Mildred B. Blount Testamentary Trust; People’s United Bank; Law Offices of Gary Oberst, P.C.; Rhoda Rudnick; and Hinckley Allen & Snyder LLP.

The Actions involved a dispute over title to certain real property located in Westport, Connecticut that was conveyed by Erling Christophersen, as grantor, to the Trust on or about August 8, 2007. Subsequent to this conveyance, the Bank loaned $3,386,609 to the Trust, which was secured by a commercial mortgage in favor of the Bank on the Westport property. This mortgage is the subject of the Foreclosure Action brought by the Bank.

As previously disclosed, John Christophersen initially claimed an interest in the Westport real property transferred to the Trust and sought to quiet title to the property and to recover money damages from the defendants for the alleged wrongful divestiture of his claimed interest in the property.

On June 25, 2012, the Bank and John R. Christophersen entered into a Settlement Agreement which resolved all differences between John R. Christophersen and the Bank, and resulted in the withdrawal (with prejudice) of the claims made by John R. Christophersen. The Settlement Agreement provides for payments by the Bank to John R. Christophersen in settlement of his claims. A payment was made at the time the Settlement Agreement was entered into and is included in the non-recurring litigation expense of $250,000 incurred by the Bank for the quarter ended June 30, 2012. Additional contingent consideration would be payable within ten days of the completion and/or resolution of the Bank’s foreclosure action, and subsequently, depending upon the amount realized upon the eventual liquidation of the foreclosed property. All claims against the Bank have been withdrawn and the Bank is no longer a defendant or counterclaim defendant in any litigation involving this matter. As an additional consequence of the Settlement Agreement, Bonnie Christophersen, Elena Dreiske and People’s United Bank are no longer parties to any of the litigation referenced above.

On July 27, 2012, Erling Christophersen filed a Motion to Restore the First Action, and on October 15, 2012 filed a Motion to Stay the Foreclosure Action pending resolution of the Motion to Restore. The Bank is opposing both motions.

There are no other material pending legal proceedings, other than ordinary routine litigation incident to the registrant’s business, to which Salisbury is a party or of which any of its property is subject.

Item 1A. **RISK FACTORS**

Not applicable

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. MINE SAFETY DISCLOSURES

Not Applicable

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS

31.1	Rule 13a-14(a)/15d-14(a) Certification.
31.2	Rule 13a-14(a)/15d-14(a) Certification.
32	Section 1350 Certifications

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SALISBURY BANCORP, INC.

/s/ Richard J. Cantele, Jr.

November 14, 2012

By: Richard J. Cantele, Jr.,

President and Chief Executive Officer

		/s/ B. Ian McMahon
November 14, 2012	By:	B. Ian McMahon Executive Vice President and Chief Financial Officer